

assets - liabilities = proprietorship
 equity = assets - liabilities
 assets = cash + loans + investments + other
 liabilities = notes payable + accounts payable + other
 proprietorship = capital + retained earnings + other

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Principles of Accounting

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20TH CENTURY ACCOUNTING

COLLEGE EDITION

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PREFACE

The first question asked by the business man when you make application to him for a position is, "What can you do?". When you reply, "I can perform any phase of work in your accounting department or I can supervise all of the work in this department", you have given a definite answer to this important question.

A knowledge of accounting will not only provide a means of entrance into the business world but also promotion to the ambitious young man or young woman. The accountant is thoroughly familiar with all the details of a business, hence better qualified to supervise the operations of a department or any specific phase of the business.

The work of the accounting department is to provide facts for the owner of the business and those in executive positions. These facts relate to the amount of property used in the operations of a business, the debts incurred to secure property, the cost of operations, and the net profit. Records are required to provide these facts. Some means must be provided to prove the correctness of the records, otherwise the facts could not be used for the purpose desired.

Thus, the accounting department provides correct facts which may be used as a basis for controlling the future operations of the business, also as a basis for credit if it is desired to buy merchandise or borrow money. Those who work in the accounting department may be required to do many kinds of clerical work, but all of this clerical work relates to compiling facts expressed in dollars and cents in such a manner that proof may be effected.

The work performed in the accounting department is described by two general terms, (1) bookkeeping and (2) accounting. These two terms are usually regarded in practice as synonymous but there is a technical distinction between them. Bookkeeping is the recording of facts so as to provide information. Accounting is a broader term and includes not only the clerical work required in connection with the accounting records, but also the method by which all the various phases of clerical work are assembled in order to present the facts in a manner which will be the most useful to the owner or executives.

A knowledge of accounting is essential to promotion. One may become efficient in the various phases of bookkeeping but without a knowledge of accounting, he cannot hope for rapid advancement. The accounts receivable ledger bookkeeper may become very proficient in this phase of bookkeeping work, but without a knowledge of accounting and the relation between his work and that of the general accounting records, he cannot hope for advancement.

The compensation of those engaged in accounting work will depend on (a) their understanding of the work and (b) their ability to do a large volume of work. An understanding of the principles can be secured from the discussions in this text; proficiency in applying these principles can be gained through completing the practice sets and through practice in the accounting department.

You are beginning the study of a very interesting and practical subject, one which will provide an entrance into the business world and an opportunity for rapid promotion if you thoroughly understand the subject. If you are to get the most out of the subject, be sure that you understand the fundamental principles and the relation of each phase of clerical work in the accounting department to the principles. When you know what you are doing, why you are doing it, and the relation of your work to that which others are doing, you will have a better opportunity for promotion than if you understand only one phase of accounting.

When you enter the business world, you should be ambitious to become an executive or the owner of a business. If this ambition is to be realized, you must thoroughly understand the subject of accounting as explained in this text and become proficient in the adaptation of the principles through the practice sets which are a part of the course. The business executive utilizes the information in the reports as a basis for controlling future operations of the business. When you understand the purpose for which the reports are required and can prepare them so that the information contained in them will be of the greatest value, you will have splendid opportunity for advancement to a position as an executive of the business.

Much clerical work is required in the accounting department. Machines are used wherever possible to reduce the amount of clerical work and provide more accurate results. This fact, however, does not excuse you from understanding all phases of clerical work and the method of securing the desired results. You must know more than a machine if you are to become more than a machine operator. Keep this fact in mind throughout your accounting course and your apprenticeship in the accounting department of a business.

Your ambition to become a business executive or a business owner can be realized through constant work and through the understanding of accounting and its relation to the operations of a business. You can hardly hope to enter the business world as an executive or a business owner, but if you get the most out of your accounting course while in school, you can hope for rapid promotion and an early realization of your ambition. The need for executives in business today is greater than at any time in the past, hence the opportunities for ambitious boys and girls are increasing daily.

THE AUTHOR

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CHAPTER I

BUSINESS AND ACCOUNTING

The purpose of accounting is to provide information about the affairs of a business, an individual or an organization, and proof of the correctness of the information. This chapter explains the relation between business and accounting, the basis of proof for accounting records, and some of the business and accounting terms with which you as a student of accounting should be familiar. The chapters which follow relate to the method of applying accounting principles to the recording of business transactions.

Business. The one who sells merchandise or service is said to be engaged in a *business*. The grocer sells groceries, hence operates a business; the department store sells various kinds of merchandise, hence operates a business. The street car company, telephone company, electric light company, and advertising agencies each sell services, hence operate a business.

Business Terms. There are many terms used in business with which you as a student of accounting should be familiar. Assets, liabilities, proprietorship, income and expense are explained in the paragraphs which follow. Other terms will be explained as their use is required in the study of accounting. The information regarding business terms is not to be memorized; it is necessary, however, to understand the meaning of the various accounting terms, hence they are given only as needed.

Assets. Anything of value *owned* by an individual or a business is referred to in accounting as an *asset*; hence, an asset is property owned by an individual or a business. Cash (money), merchandise (groceries, clothing, shoes, etc.), equipment (counters, desks, mechanical appliances, machinery, etc.), and accounts receivable (expressed or implied promises made by others to pay for property received from the business) are examples of assets owned and used in the operations of a business. Asset values are expressed in dollars and cents because money is the medium of exchange and the standard of value.

Liabilities. A debt *owed* by an individual or by a business is known in accounting as a *liability*. Thus, a liability is an implied, verbal or written promise made by an individual or the proprietor of a business to pay a certain amount, usually in cash, at some time in the future. Debts owed for merchandise purchased (accounts payable) and written promises (notes payable) are examples of the liabilities usually incurred in the operation of a business.

Proprietorship. All assets are owned. The proprietor's exclusive right to the assets used in the operations of his business is known in accounting as *ownership*, *proprietorship* or *capital*. When there are no liabilities, the owner's proprietorship is the same as the value of his assets. When there are liabilities, the owner's proprietorship is the value of the property less the liabilities.

Income. When cash or other assets are received for merchandise sold, the transaction usually results in an increase in the assets and proprietorship. The increase in proprietorship resulting from an increase in assets is known in accounting as *income*.

Expense. When cash is paid for rent, salaries, telephone service, and similar services, the assets decrease the amount paid and the proprietorship decreases the same amount. The term *expense* is used in accounting to describe decreases in proprietorship resulting from assets given by the business for service rendered to it.

Business Transactions. A change in assets, liabilities, assets and liabilities or assets and proprietorship is known in accounting as a *business transaction*. Transactions are usually the result of the exchanges incident to the buying and selling of merchandise, property or service, and the payment of expenses. The changes in assets, liabilities and proprietorship which occur when a transaction of a specific nature is completed may be illustrated as follows:

Cash paid for merchandise purchased causes a change in the assets, the asset cash being decreased and the asset merchandise increased the amount of the cash paid.

Merchandise purchased with an expressed or implied promise to pay for it at a later date causes a change in the assets and liabilities, the asset merchandise being increased and the liabilities increased the amount of the purchase.

Cash paid for rent causes a change in the assets and proprietorship, the cash being decreased and proprietorship decreased the amount of cash paid.

Cash received for merchandise sold at a price greater than the cost causes a change in the assets and in the proprietorship, the asset cash being increased the amount of the cash received, the asset merchandise decreased the cost of the merchandise sold and the proprietorship increased the difference between the cost and selling price.

Purpose of a Business. The proprietor of a business operates it in order that he may make a profit, that is, increase the amount of his proprietorship in the assets of the business. This profit is secured through selling merchandise or service at a price greater than the cost. Certain expenses are involved in the operation of the business such as rent, heat, light, salaries, etc. The profit obtained by selling merchandise or service should be sufficient to pay the expenses and provide a *net profit* for the owner.

Method of Ascertaining Profit. The profit is ascertained after a definite period of operations, usually one month, six months or a year. The

amount of the profit is the difference between the proprietorship at the end of the period and the proprietorship at the beginning of the period. Since proprietorship is the total assets less the total liabilities, it is necessary to count the assets and liabilities at the time it is desired to ascertain the amount of the profit.

C. H. Field began a retail shoe business July 1 with a cash investment of \$5,000.00. July 31 he wished to ascertain the amount of his profit for the month. A count of the assets owned and used in the operation of the business July 31 shows that the amount of the assets is \$5,831.25. All of the assets, however, are not paid for. C. H. Field finds that he owes A. D. Mann \$316.25 for shoes purchased, but the promise to pay does not mature until August. The value of his property, \$5,831.25, minus \$316.25, the amount of his liabilities, equals \$5,515.00, his proprietorship July 31.

The proprietorship July 31, \$5,515.00, minus \$5,000.00, the proprietorship July 1, equals \$515.00, profit for July. In other words, C. H. Field has made a profit of \$515.00 because his proprietorship July 31 is this amount greater than his proprietorship July 1. It is assumed that C. H. Field did not invest additional assets nor withdraw any assets during July. The effect on profit of additional investments and withdrawals by the proprietor is explained in a subsequent discussion.

Need for Records. It is quite evident that the proprietor of a business must provide some means of knowing that the count of his assets and the amount of his liabilities are correct, otherwise he would not know that the amount of profit shown by a comparison of the beginning and ending proprietorship is the correct amount. Thus, if C. H. Field records each amount of cash received and each amount of cash paid during the month of July, he will know the amount of cash he should have on hand July 31. If a count of the cash on hand July 31 agrees with the record of the cash receipts and payments, C. H. Field will know that the count of cash is correct. A similar record of each asset and each liability will provide the amount of the asset and the liability.

REPORTS

There is little purpose in reading the text discussion unless you understand it and can submit to the instructor concrete evidence that you do understand it. You will find in the work book blanks in the form of reports which permit you to submit to the instructor the desired evidence.

At this time you are required to complete Report No. 1; see instructions on the front cover of the work book. When Report No. 1 has been completed and submitted to the instructor for approval, continue with the text discussion beginning at the top of page 6 until Report No. 2 is required on page 10.

Proof of Records. Information regarding the amount of assets, liabilities or proprietorship is of little value to the owner of a business unless there is substantial proof of correctness. In other words, the records must be kept so that they may be proved to be correct. Thus, if a record of cash receipts and payments maintained by C. H. Field shows that he should have \$350.00 cash on hand and a count shows only \$320.00, it is quite evident there is an error of \$30.00 either in the count or in the records. If the records can be proved to be correct, C. H. Field will know that either the count is incorrect or some of the cash received or paid has not been recorded.

Basis of Proof of Records. The information provided by the accounting records is stated in dollars and cents because all property values are measured through the medium of money. If the records are to be proved, it is necessary to provide some means of checking one amount against another so that if either is recorded incorrectly, the one who makes the record will at least know that the records are not in balance. In other words, it is necessary to record each amount involved twice in such a manner that the final results or total amounts recorded may be proved to be in balance. The *accounting equation* provides the basis for recording the amount in each transaction twice in such a manner so as to effect the desired proof.

The Accounting Equation. The word "equation" implies things of like character and equal in value. As used in accounting, it applies to the fact that the amount of the assets equals the amount of the owner's proprietorship or that the amount of the assets equals the amount of the liabilities plus the owner's proprietorship. The assets are placed at the left and the liabilities and proprietorship at the right with the equality sign (=) between them as illustrated below.

$$\text{ASSETS} = \text{PROPRIETORSHIP}$$

or

$$\text{ASSETS} = \text{LIABILITIES} + \text{PROPRIETORSHIP}$$

Applying this equation to the assets and proprietorship July 1, of C. H. Field, the retail shoe merchant referred to on page 5, and his assets, liabilities and proprietorship July 31, the equations are

July 1

$$\text{ASSETS } \$5,000.00 = \text{C. H. FIELD, PROPRIETORSHIP } \$5,000.00$$

July 31

$$\text{ASSETS } \$5,831.25 = \text{LIABILITIES } \$316.25 + \text{C. H. FIELD, PROP. } \$5,515.00$$

If the assets July 31 are composed of cash \$2,266.25, and merchandise \$3,565.00, and the liability of \$316.25 is owed to A. D. Mann, the facts stated in equation form are:

$$\text{CASH } \$2,266.25 + \text{MDSE. } \$3,565 = \text{A. D. MANN } \$316.25 + \text{C. H. F., PROP. } \$5,515$$

The method of using this equation as a basis for recording the amount in each transaction twice so as to provide the desired information and proof of the record is explained and illustrated on pages 7 and 8.

Illustrations. The use of the equation for providing proof of records and the desired information regarding assets, liabilities and proprietorship is further explained by illustrations. The illustrations apply to the transactions completed by C. H. Field on August 1 as follows:

- (a) Paid cash, \$100.00, for August rent.
- (b) Received cash, \$150.00, for shoes sold which cost \$110.00.
- (c) Paid A. D. Mann cash, \$316.25, amount owed him.
- (d) Purchased from A. D. Mann on time shoes for \$151.25.
- (e) Received cash, \$250.00, for shoes sold which cost \$160.00.

The assets, liabilities and proprietorship of C. H. Field, August 1, (page 6), and the same information after each transaction is completed, stated in equation form, are as follows:

CASH	\$2,266.25	+	MDSE.	\$3,565.00	=	A. D. MANN	\$316.25	+	C. H. FIELD, PROP.	\$5,515.00
(a)	<u>- 100.00</u>									<u>- 100.00</u>
CASH	\$2,166.25	+	MDSE.	\$3,565.00	=	A. D. MANN	\$316.25	+	C. H. FIELD, PROP.	\$5,415.00
(b)	<u>+ 150.00</u>			<u>- 110.00</u>						<u>+ 40.00</u>
CASH	\$2,316.25	+	MDSE.	\$3,455.00	=	A. D. MANN	\$316.25	+	C. H. FIELD, PROP.	\$5,455.00
(c)	<u>- 316.25</u>						<u>- 316.25</u>			
CASH	\$2,000.00	+	MDSE.	\$3,455.00	=				C. H. FIELD, PROP.	\$5,455.00
(d)				<u>+ 151.25</u>			<u>+ 151.25</u>			
CASH	\$2,000.00	+	MDSE.	\$3,606.25	=	A. D. MANN	\$151.25	+	C. H. FIELD, PROP.	\$5,455.00
(e)	<u>+ 250.00</u>			<u>- 160.00</u>						<u>+ 90.00</u>
CASH	\$2,250.00	+	MDSE.	\$3,446.25	=	A. D. MANN	\$151.25	+	C. H. FIELD, PROP.	\$5,545.00

The equation at the beginning, August 1, as stated at the bottom of page 6, is shown in the first equation. As a result of the first transaction, the asset cash decreases \$100.00 and the proprietorship decreases \$100.00. Subtracting equal amounts from both sides of the equality sign gives the second equation which is the assets, liabilities and proprietorship after the first transaction.

As a result of the second transaction, the asset cash increases \$150.00, the asset merchandise decreases \$110.00 and the proprietorship increases \$40.00, the amount of the profit. Adding \$150.00 and subtracting \$110.00 on the left of the equality sign and adding \$40.00 on the right of the equality sign maintains the equality of the two sides of the equation and gives the third equation which is the assets, liabilities and proprietorship after the second transaction is completed.

As a result of the third transaction, the assets and liabilities each decrease \$316.25; the fourth transaction, the assets and liabilities each increase \$151.25; and the fifth transaction, the assets increase and decrease and the proprietorship increases. The assets, liabilities and proprietorship after the third, fourth and fifth transactions are ascertained by addition and subtraction in the manner described in the two paragraphs above.

Account Form. The illustration for securing proof of records would not be practical in recording transactions because too much clerical work would be involved and there is other information which the accounting records must provide. For the reasons stated, the account form has been devised by accountants for recording the amounts involved in transactions so as to provide the needed information regarding each asset, each liability and the owner's proprietorship in the assets.

The illustration at the left is a simple form of an account sometimes referred to as a "T" account. You will observe that this is a vertical line with a horizontal line at the top.

The name of the asset, the liability or the proprietor is written on the horizontal line at the top as "Cash" in the illustration. The vertical line divides the account into two sides and indicates subtraction, that is, the smaller amount on the one side is to be subtracted from the larger amount on the other side.

Illustrations. The method of recording in accounts the five transactions completed by C. H. Field, August 1, (page 7), is illustrated below. Accounts are provided for the four elements in the first equation. Amounts on the left of the equality sign are recorded on the left of the appropriate accounts, and amounts on the right of the equality sign, on the right of the appropriate accounts. Addition and subtraction are indicated in the equations on page 7 by the plus and minus signs; addition and subtraction are indicated in the accounts by the left and right side of each account.

CASH		MERCHANDISE		A. D. MANN		C. H. FIELD, PROP.	
2266.25	100.00	3565.00	110.00	316.25	316.25	100.00	5515.00
150.00	316.25	151.25	160.00		151.25		40.00
250.00	416.25	3716.25	270.00		467.50		90.00
2666.25							5645.00

CASH \$2,250 + MDSE. \$3,446.25 = A. D. MANN \$151.25 + C. H. F., PROP. \$5,545

Proof. The small figures in each account indicate addition. The difference between the two sides of each account, stated in equation form, is the same as the facts stated in the last equation on page 7. Below is a list of the accounts with the totals of each side also the difference between the two sides. In each case the left side total or balance is in the first column and the right side total or balance in the second column.

	TOTALS		DIFFERENCES	
Cash.....	2666.25	416.25	2250.00	
Merchandise.....	3716.25	270.00	3446.25	
A. D. Mann.....	316.25	467.50		151.25
C. H. Field, Prop.....	100.00	5645.00		5545.00
	6798.75	6798.75	5696.25	5696.25

The proof indicates that the amount involved in each transaction has been correctly recorded twice and the record has been made in such a manner that the totals of amounts recorded in one way equal the total of amounts recorded in another way.

Analysis of Accounts. The amounts on the left of the equality sign in the first equation are recorded on the left side of accounts and those on the right, on the right side of accounts. Thus, the sum of the amounts on the left side of the accounts equals the sum of the amounts on the right side of the accounts after the facts in the equation are recorded in accounts.

At least two accounts are required to record each transaction because when an asset increases, either another asset decreases or the proprietorship increases; when an asset decreases, either some other asset increases or the proprietorship decreases. The amount in each transaction is recorded twice and on opposite sides of two or more accounts as follows:

The \$100.00 cash payment in the first transaction is recorded on the right side of the Cash account to indicate subtraction and on the left side of the proprietorship account to indicate subtraction.

Three accounts are required to record the second transaction; \$150.00 is recorded on the left side of the Cash account, \$110.00 on the right side of the Merchandise account and \$40.00 on the right side of the proprietorship account.

The \$316.25 in the third transaction is recorded on the right side of the Cash account and on the left side of the account with A. B. Mann. In the same way the amount involved in the fourth transaction is recorded twice in two accounts and the two amounts in the fifth transaction recorded in three accounts so as to maintain the equality of the two sides of the equation.

Proof of the Records. The difference between the two sides of each account, as stated in the second column in the proof illustrated at the bottom of page 8, is the same as the amount in the last equation in the illustration on page 7. In other words, the same facts are obtained whether addition and subtraction are indicated by the plus and minus signs and the mathematical process completed, or whether the changes are recorded in account form with addition and subtraction indicated by position.

Terms Applicable to Accounts. When discussing accounts, accountants usually use the following terms: title, debit, credit and balance. The meaning of these terms is explained in the following paragraphs.

Title. The purpose of an account is to provide a record of the amounts which affect one asset, one liability or the proprietorship. The word or words which describe the nature of the asset, liability or proprietorship and which are written at the top of the account are referred to as the *title* of the account. Thus, the title of the account which is to contain a record of the amounts of cash received and paid is Cash. The title of an account should always be descriptive of the asset, liability or proprietorship so that anyone may correctly interpret the information recorded in it.

Debit. The left side of an account is referred to as the *debit* side; abbreviated, as Dr. Thus, if an amount is to be entered on the left side of the Cash

account because the asset cash is increased, the entry is described as "Debit the Cash account."

You will observe from the illustrations on page 8 that *increases* in assets, *decreases* in liabilities, and *decreases* in proprietorship are debits.

Credit. The right side of an account is referred to as the *credit* side; abbreviated, as Cr. Thus, if an amount is recorded on the right side of the account with A. D. Mann because the liabilities have increased, the entry is described as "Credit the account with A. D. Mann."

You will observe from the illustrations on page 8 that *decreases* in assets, *increases* in liabilities and *increases* in proprietorship are credits.

Balance. The difference between the two sides of an account is referred to as the *balance*. Thus, the difference between the two sides of the Cash account, page 8, is \$2,250.00 and is referred to as the *cash balance*. When only one amount appears on the left or right side of the account, this one amount is the balance. When two or more amounts appear on the left or right side of an account with no amount on the other side, the sum of the amounts is the balance. An account is said to be *open* when the two sides are not equal, and *closed* when they are equal.

Equality of Debits and Credits. As explained in a preceding paragraph, proof can be obtained only through recording the amount in each transaction twice in such a manner that proof may be effected through the totals being the same. You will observe from the illustration that the amount in each transaction is recorded twice and that the desired proof is secured either when the record is made on the equation or in the accounts. This method of recording amounts so as to provide proof is referred to in accounting as *maintaining the equality of debits and credits*.

Debiting and Crediting Accounts. The account is an accounting device for ascertaining information regarding assets, liabilities and proprietorship. The term "debit" describes the left side of an account, "credit" the right side, and "balance" the difference between the two sides.

Increases in assets, decreases in liabilities and decreases in proprietorship are recorded as debits in the appropriate accounts.

Decreases in assets, increases in liabilities and increases in proprietorship are recorded as credits in the appropriate accounts.

REPORT

At this time you are to complete Report No. 2 in the work book and submit it to the instructor for approval. When Report No. 2 has been completed, continue with the text discussion beginning with Chapter II until Report No. 3 is required on page 15.

CHAPTER II

RECORDING CASH TRANSACTIONS

The information provided through the accounting records as it relates to dollars and cents is obtained from the accounts. Thus, accounting is account-keeping, that is, recording transactions so that account balances will show the desired information. The discussion in this chapter relates to the method of recording cash transactions, that is, those transactions in which the asset cash is increased or decreased as a result of each transaction completed.

Account. The accountant uses the account as a means of indicating addition and subtraction by position when recording the changes in assets, liabilities and proprietorship. Thus, an account is maintained with each asset, each liability, the proprietor, each increase in proprietorship and each decrease in proprietorship. Increases in assets, decreases in liabilities and decreases in proprietorship are recorded as debits in the appropriate accounts; decreases in assets, increases in liabilities and increases in proprietorship are recorded as credits in the appropriate accounts.

Ledger. A group of accounts containing a record of transactions in account form is referred to as the *ledger*. The information in each account may be recorded on a card, on a loose sheet punched to fit a binder or on a page in a bound book. The ledger, therefore, may be a group of cards, a number of loose sheets in a binder, or a bound book.

The account form illustrated in the preceding chapter provides for recording debits and credits and the amount involved but does not provide for all the needed information. For this reason the ledger is usually ruled with columns for the date of the transaction, the explanation, the page and the amount. The illustration below shows one form of ledger ruling and the illustration on page 13, a group of accounts comprising a ledger.

TITLE OF THE ACCOUNT											
(Debits)						(Credits)					
Year Mo.	Day	Explanation	Page	Dollars	Cts.	Year Mo.	Day	Explanation	Page	Dollars	Cts.
			Book of Orig. Entry						Book of Orig. Entry		

Illustration 1. One Form of Ruling for a Ledger

Recording Cash Transactions. Each cash transaction is a change in the asset cash with a corresponding change in some other asset, in a liability, or in the proprietorship. Five or more accounts are required to record the cash transactions completed in a mercantile business. The minimum number of accounts are Cash, Capital, Sales, Purchases and Expense.

The Cash account is debited for each amount of cash received, and credited for each amount of cash paid. The Capital account is credited for the cash invested. The Sales account is credited for the amount of each sale and debited for merchandise returned by the one to whom it was sold. The Purchases account is debited for the cost of merchandise purchased and credited for the cost of merchandise returned to the one from whom it was bought. The Expense account is debited for the amount of each expense.

Debiting Purchases for the cost price and crediting Sales for the selling price does not record the change in the asset merchandise because of sales; the change in the asset merchandise because of sales is recorded at the time it is desired to ascertain proprietorship as will be explained in subsequent lessons. An expense is a decrease in proprietorship, hence debiting the Expense account has the same effect as debiting the account with the proprietor.

Illustrations. The method of recording cash transactions direct in the accounts is further explained by illustrations. The transactions used as a basis for the illustrations are those completed by R. M. Drake during the week beginning Monday, July 2, and are as follows:

2. R. M. Drake invested \$750.00 in cash in a soft drink business.

Recorded as a debit to the Cash account and a credit to R. M. Drake, Capital account

2. Paid cash for ice cream and soft drinks, \$127.50.

Recorded as a debit to the Purchases account and a credit to the Cash account.

3. Paid July rent, \$75.00.

A decrease in the asset cash and a decrease in proprietorship known as expense.

3. Received cash \$63.42 for cash sales to date.

Increase in the asset cash and an increase in sales.

3. Returned 1 gallon ice cream purchased on the 2d and received \$2.50 in cash, cost price of the ice cream.

Recorded as a debit to the Cash account and a credit to the Purchases account.

4. Paid cash for sandwiches and ice cream, \$48.90.

6. Received cash \$54.63 for cash sales to date.

7. Gave C. A. Sands \$1.50 in cash for one-half gallon ice cream which he returned because it was delivered to him in bad condition.

7. Received cash \$75.65 for cash sales to date.

7. Paid clerk \$12.50 in cash, salary for the week.

These ten transactions are recorded in the ledger, Illustration 2, on the opposite page. Comparing the narrative with the illustration, you will observe the following:

(1) The amount in each transaction is recorded twice.

(2) Each increase in the asset cash is recorded on the debit side of the Cash account and the same amount recorded on the credit side of (a) the account with the proprietor, (b) the Sales account, or (c) the Purchases account.

(3) Each decrease in the asset cash is recorded on the credit side of the Cash account and the same amount recorded on the debit side of (a) the Purchases account, (b) the Sales account or (c) the Expense account.

The reason for each entry is made clear in the preceding chapter and the discussion relative to the accounts on pages 14 and 15. Be sure that you understand the reason for each entry.

Cash

19				19			
July 2		750 -	July 2			127 50	
3		63 42	3			75 -	
3		250	4			48 90	
6		54 63	7			150	
7	680 80	756 50	7			163 50	

R M Drace Capital

			19				
			July 2			750 -	

Sales

19				19			
July 7		150	July 3			63 42	
			6			54 63	
			7	192.20		75 63	
						95 70	

Purchases

19				19			
July 2		127 50	July 3			250	
4	173.90	489 40					

Expense

19							
July 3		75 -					
7		1250					
		8750					

Illustration 2, Ledger

Trial Balance. The Trial Balance is a list of the open accounts (those not in balance) in the ledger with the balance written on a line with the title of the account, debit balances being placed in one column and credit balances in another. Each transaction is recorded so as to maintain the equality of debits and credits in the ledger, that is, each amount recorded on the debit

side of one account is recorded on the credit side of another account or vice versa. When it is desired to prove the equality of debits and credits in the ledger, a *Trial Balance* is prepared; see illustration of Proof on page 8.

The illustration below shows a Trial Balance prepared from the five accounts in the ledger, Illustration 2, page 13.

R. M. Drake
Trial Balance July 7, 19--

13	Cash	680	80	
13	R. M. Drake Capital			750 --
13	Sales			192 20
13	Purchases	173	90	
13	Expense		87	50
		942	20	942 20

Illustration 3, Trial Balance

The Cash Account is a record of the changes in the asset cash. It is *debited* with the increases and *credited* with the decreases. The *debit* balance is an asset and should agree with the cash on hand which may be in the safe, in the bank, or a part in both places. Ascertaining that the cash on hand agrees with the balance of the Cash account is referred to as *proving cash*.

The Capital Account is a record of the investments by the proprietor. It is *credited* with the beginning investment, subsequent investments and net profit, and *debited* with withdrawals from investment and net loss. The *credit* balance shows the net investment. The title of the Capital account is the name of the proprietor and the word "Capital" or "Proprietorship".

The Drawing Account is a record of the withdrawals of cash and other assets by the owner of the business for his personal use. It is *debited* with the amount of each withdrawal; this account is usually not credited. The title of the Drawing account is the name of the proprietor and the word "Drawing" or "Personal". See note under Expense account, page 15.

The Sales Account is a record of the income from sales. It is *credited* with the selling price of the merchandise sold and *debited* with the selling price of merchandise returned to the business or with allowances which reduce the amount of the sales. The *credit* balance shows the net income from sales.

Each sale is the result of assets received. The asset account is debited to record the increase in assets, and the Sales account credited to record the increase in proprietorship. A credit to the Sales account is equivalent to a credit to the account with the proprietor because it is regarded as an increase in proprietorship. The full amount of each sale is not an income because it includes the cost of the merchandise sold. At the time it is desired to ascertain proprietorship and profit, the cost of merchandise sold in all sales is recorded in one amount as is explained in Chapter VI.

The Purchases Account is a record of the amount of merchandise purchased and made available for sale. It is *debited* with the cost price of the merchandise purchased; this debit includes the invoice cost and the freight on merchandise purchased. The Purchases account is *credited* for the cost price of merchandise returned to those from whom it was bought and for allowances which reduce the purchase cost. The *debit* balance shows the net purchases.

The title Purchases is more descriptive than Merchandise. Debiting the Purchases account has the same effect as debiting the Merchandise account in that it records the increase in the asset merchandise. It is customary in business to record the cost of the merchandise purchased in the Purchases account and the selling price of merchandise sold in the Sales account. The asset value of the merchandise involved in each sale is not recorded as a credit to the Purchases account at the time the sale is made but must be recorded at the time proprietorship and profit is ascertained as explained in Chapter VI.

The Expense Account is a record of the decreases in proprietorship resulting from the cost of operating the business. It is *debited* for decreases in proprietorship at the time the expenses are paid; this account is usually not *credited*. The *debit* balance shows the total expense.

If more information is needed regarding expenses, separate accounts may be maintained with each kind of expense as Rent Expense, Salary Expense, Insurance Expense and similar titles of a descriptive nature.

When the proprietor withdraws assets from the business, the assets and proprietorship each decrease the same amount. When these assets are given to others in payment for operating expenses, the decrease in proprietorship is recorded as an expense to be deducted from the income. When the owner uses these assets for his own personal needs or the needs of his family, the decrease in proprietorship cannot be recorded as an expense deductible from income but because of income tax ruling must be recorded as a withdrawal in anticipation of profit. This is explained and illustrated in Chapter V.

REPORT

You are to complete Report No. 3 in the work book and submit it to the instructor as evidence that you understand how to record cash transactions direct in the ledger. When Report No. 3 has been completed, continue with the text discussion until Report No. 4 is required on page 20.

Book of Original Entry. The changes in assets and proprietorship because of cash transactions completed may be recorded direct in the ledger as illustrated. When this plan is followed, however, it is not possible to show all the desired information. Another disadvantage is the inconvenience of locating errors should the ledger be out of balance.

For the reasons stated and others which will be made apparent, it is customary to record each transaction at the time it is completed in a book of original entry. The information recorded in the book of original entry includes

- (1) date of the transaction,
- (2) name of the account debited and the amount,
- (3) name of the account credited and the amount,
- (4) explanation of the transaction.

Journal. A book of original entry in which all the transactions may be recorded is known as a *journal*. The ruling of the journal, which is usually a bound book, provides for recording the desired information regarding transactions in a more efficient manner. The illustration below shows a typical journal form and the one on page 18, a similar form with a number of transactions recorded on it.

The date of the first transaction recorded on a page is written on a blue line at the top of the page; the date of each subsequent transaction on the page is written in the center from left to right and on the blue line next below the last transaction recorded. The transactions are recorded chronologically, that is, in the order in which they are completed.

The amount to be recorded on the debit side of an account is entered in the first (from left to right) money column and the account title written on the same line with it and at the left. The amount to be recorded on the credit side of an account is entered in the second money column (from left to right) and the account title written at the left on the same line with it but *indented*.

The explanation of the transaction is written below the name of the account to be credited. The column at the left marked "L. F." (ledger folio, that is, ledger page) is used when posting.

Date		Debit		Credit	
L F	Name of Account Debited	Dollars	Cts.	Dollars	Cts.
	Name of Account Credited				
	Explanation of the transaction.				
	(Date of next entry)				
	[The succeeding entries on the page are made in the same manner as the first entry]				

Illustration 4, One Form of Ruling for a Journal

Journalizing. A transaction is a change in one asset which brings about a change in some other asset, liability or the proprietorship. These changes are recorded in the journal at the time the transaction is completed so that the same information may be transferred to the accounts in the ledger. Determining the accounts to be debited and credited and recording these facts in the journal is referred to as *journalizing*. The following is used as a basis for determining the debits and credits in the journal entries.

- (1) Increases in assets, decreases in liabilities and decreases in proprietorship are recorded as debits in the appropriate accounts.
- (2) Decreases in assets, increases in liabilities and increases in proprietorship are recorded as credits in the appropriate accounts.

Posting the Journal. The process of transferring the amounts recorded in the journal to the appropriate accounts in the ledger is referred to as *posting*. The amounts recorded in the journal are posted to the ledger in the same order as they appear in the journal; the purpose of posting is to provide in account form in the ledger the same information as is recorded in the journal.

Each amount in the first money column (from left to right) is posted to the debit side of the account written on the same line with it. Each amount in the second money column is posted to the credit side of the account written on the same line with it. The posting is indicated by writing the page of the journal in the folio column in the ledger; the page of the account in the ledger is written in the folio column in the journal for reference.

The transactions recorded in the journal, Illustration 5, page 18, are shown posted to the ledger, Illustration 6, page 19. The pages in the folio columns of the journal and ledger illustrated are the pages on which the illustrations appear in the text.

Illustrations. The method of recording transactions in the journal and posting is further explained by illustrations. These illustrations are applicable to the transactions on page 12, used in the previous illustration. The following comments refer to the entries in the journal, page 18, and the ledger, page 19, it being assumed that each entry was posted as soon as it was recorded.

Analysis of Journal Entries. The first entry records an increase of \$750.00 in the asset cash and in the investment, hence requires a debit to the Cash account and a credit to the Capital account. The debit and the credit are each indicated in the journal by the position of the account title and the amount. When posted, the Cash and Capital accounts contain the same information as the journal.

The second entry records an increase of \$127.50 in the asset merchandise and a decrease of the same amount in the asset cash. Debits and credits are indicated by position. When posted, the Purchases and Cash accounts will show the same information as the journal. Keep in mind the fact that the pages in the folio columns of the journal and ledger are entered at the time of posting and the folios in the illustrations refer to the pages in this text.

The third entry records a decrease of \$75.00 in proprietorship and cash through the payment of rent. The debit and credit are indicated in the journal entry by position. When posted, the Expense and Cash accounts will contain the same information as the journal entry.

The fourth entry records an increase of \$63.42 in the asset cash and the income sales. The debit and credit are indicated in the journal by position. When posted, the Cash and Sales accounts will contain the same information as the journal entry.

In the same manner, each of the six remaining entries in the journal, Illustration 5, records changes in assets or assets and proprietorship so that these changes may be recorded in the ledger under the appropriate account titles.

(Continued on page 19)

July 2, 1911

19	Cash	750	-	
19	R. M. Drake, Capital			750 -
	Investment in soft drink parlor			
	2			
19	Purchases	127	50	
19	Cash			127 50
	Paid cash for sundries and soft drinks			
	3			
19	Expense	75	-	
19	Cash			75 -
	Paid July rent			
	3			
19	Cash	63	42	
19	Sales			63 42
	Cash sales to date			
	3			
19	Cash	250		
19	Purchases			250
	Received cash for gelatin cream sold			
	4			
19	Purchases	48	90	
19	Cash			48 90
	Paid cash for sundries and ice cream			
	6			
19	Cash	54	63	
19	Sales			54 63
	Cash sales to date			
	7			
19	Sales	150		
19	Cash			150
	Paid cash for 3 gal. ice cream returned			
	7			
19	Cash	75	65	
19	Sales			75 65
	Cash sales to date			
	7			
19	Expense	12	50	
19	Cash			12 50
	Paid clerk's salary for the week			

Illustration 5, The Journal

Cash

19	July 2	18	750 -	19	July 2	18	127 50
	3	18	63 42		3	18	75 -
	3	18	250		4	18	48 90
	6	18	54 63		7	18	150
	7	18	75 65		7	18	2 62 50
			680 80				

R M Drake Capital

	July 2	18	750 -
--	--------	----	-------

Sales

19	July 7	18	150	19	July 3	18	63 42
					6	18	54 63
					7	18	192 20
							75 65
							92 70

Purchases

19	July 2	18	127 50	19	July 3	18	250
	4	18	173 90				
			48 90				
			75 65				
			92 70				

Expense

19	July 3	18	75 -				
	7	18	12 50				
			17 50				

Illustration 6, Ledger Resulting from Posting Illustration 5

(Continued from page 17)

Keep in mind the fact that debiting Purchases has the same effect as debiting Merchandise in that it records the increases in the asset merchandise because of a purchase. Crediting Sales has the same effect as crediting the proprietor for the profit on the sales but does not include the credit to the Purchases account for the cost of the merchandise sold. The cost of all merchandise sold is recorded in one amount as a credit to the Purchases account at the time it is desired to ascertain proprietorship and profit; this will be explained in a subsequent lesson.

Trial Balance. The ledger on page 13 and the ledger on page 19 each contain the same information except the ledger on page 19 shows the pages of

the journal because the information recorded in it was obtained from the journal. The information in the ledger on page 13 was recorded in the accounts direct from the transactions. Since the amounts recorded in the two ledgers are the same, a Trial Balance prepared from the ledger in Illustration 6, page 19, will be the same as the Trial Balance in Illustration 3, page 14.

Proprietorship and Net Profit. It is not customary in business to ascertain profit at the end of each week, hence you may assume that R. M. Drake has not required the profit earned as a result of the operations for the week. The method of ascertaining proprietorship and profit is explained in connection with the model set, Chapters V and VI. You will undertake to master the lessons in bookkeeping as they are presented and not those which are to be presented. Reference is made to the advanced lessons because there is a relation between the information in each lesson. You must understand that the accounting procedure includes not only the recording of the transactions so as to provide information in accounts but also the method of ascertaining the profit from the account balances resulting from the records.

REPORTS

Three reports are required at this time, Nos. 4, 5, and 6. These reports are on pages 9-20 of the work book. You are to complete them in the order stated, that is, Nos. 4, 5 and 6.

No. 4, pages 9 and 10 in the work book, requires journalizing independent transactions. Note carefully the comments relative to journalizing on page 16, and the form of the journal in Illustration 5, page 18. Also compare the transactions on page 12 with the record in the journal and with those you are required to record in the report.

While the teacher is examining Report No. 4, you will complete No. 5, pages 11-16 in the work book. In the completion of this report you are required to record a series of transactions in journal form similar to the illustration on page 18, and post to a ledger similar in form to the illustration on page 19. The first five transactions have been recorded and posted, hence you will have this completed work and the illustrations in the text as a guide for the work you are to do.

While the teacher is examining Report No. 5, you will complete Report No. 6, pages 17-20 in the work book. Completion of this report requires recording a series of transactions, posting and the Trial Balance. With the illustrations in the text and the information gained from the previous reports, you should have no trouble completing this report. When completed, present to the instructor and while he is examining it, continue with the text discussion beginning with Chapter III until Report No. 7 is required on page 28.

CHAPTER III

RECORDING PURCHASES AND SALES ON CREDIT

The purpose of accounting is to provide information through account balances. The merchant who buys merchandise on credit and sells merchandise on credit will need more information than the one who buys and sells for cash. The discussion in this chapter relates to the method of recording purchases and sales of merchandise when cash is not paid at the time of the purchase or collected at the time of the sale.

Purchases on Credit. When the proprietor of a business receives merchandise through a purchase but does not pay for it at the time of the purchase, he incurs a *liability*. A purchase of merchandise on credit results in an increase in the asset merchandise and an increase in the liability usually referred to as *accounts payable* for the amount of the purchase. The amount of each purchase of merchandise on credit is recorded as a debit to the Purchases account to record the increase in purchases and as a credit to the account with the one from whom the purchase is made, usually referred to as a *creditor*, to record the increase in the liability accounts payable.

When cash is paid to cancel the liability at maturity, the transaction results in a decrease in the asset cash and a decrease in the liability accounts payable for the amount of cash paid. Each payment of cash to a creditor either in part or in full of the amount owed him is recorded as a debit to the account with the creditor and a credit to the Cash account for the amount of cash paid.

Terms. When the proprietor of a business purchases merchandise on credit, the time of payment is expressed or implied and referred to as the *terms* of the purchase. Thus, "Terms 30 days" means that the amount is due 30 days from the date of the purchase. A purchase on May 10, terms 30 days, is due June 9. When there are no specific terms, the terms of purchase are said to be *on account* which means that the amount is due on the first of the following month. Thus, a purchase on July 7, terms on account, is due the first of August.

Account with a Creditor. The title of the account with each creditor is his name and address. The purpose of the account with each creditor is to contain a record of the transactions with him.

Since accounts payable are liabilities, the account with a creditor is *credited* for the increases (purchases from him) and *debited* for the decreases (usually cash paid him or merchandise returned to him). The *credit* balance

is the amount owed the creditor. The sum of the credit balances of all accounts with creditors is the liability *accounts payable*.

The maturity date is indicated by writing the terms of each purchase in the explanation column. No information in the explanation column on a line with the amount of a purchase indicates that the terms are on account.

Sales on Credit. There are two methods of selling (a) for cash, and (b) on credit. When cash is received at the time the sale is made, the transaction is referred to as a *cash sale*. When cash is not received for the merchandise sold at the time of the sale but instead is to be received later, the transaction is referred to as a *charge sale*, a *sale on credit*, or a *sale on account*.

The one to whom merchandise or service is sold is referred to as a *customer*. The customer from whom cash is received at the time of the sale is a *cash customer*; the customer from whom cash is received at a date later than the date of the sale is known as a *charge customer*.

Terms. When a charge sale is made, a definite time for collection is expressed or implied. With retail merchants, the implied time is usually the first of the month following the sale. With wholesale merchants, the time is stated in definite terms, that is, a designated number of days after the date of the sale as explained in connection with terms on purchases. A sale with no specific terms is said to be *on account*.

Each sale of merchandise on credit results in an increase in the asset usually referred to as *accounts receivable* and an increase in sales. The amount of each charge sale is recorded as a debit to the account with the charge customer to record the increase in assets and as a credit to the Sales account to record the increase in sales.

When cash is received from a charge customer in collection of a part or all of his account, the transaction results in an increase in the asset cash and a decrease in the asset accounts receivable for the amount of cash received. Each collection of cash from a charge customer is recorded as a debit to the Cash account to record the increase in the asset cash and a credit to the account with the charge customer to record the decrease in the asset accounts receivable.

Account with a Charge Customer. The title of the account with each charge customer is his name and address. The purpose of the account with each charge customer is to contain a record of the transactions with him.

Since accounts receivable are assets, the account with each charge customer is *debited* for increases (sales to him) and *credited* for decreases (usually cash received from him or merchandise returned by him).

The *debit* balance is an asset because it is the amount to be collected from the charge customer. The sum of the debit balances of all accounts with charge customers is the asset *accounts receivable*.

The maturity of each sale is indicated by writing the terms in the explanation column of the ledger; no terms indicate maturity on the first of the following month.

Ruling the Account with a Creditor or Customer. When posting to the account with a customer or creditor, it is customary to rule each account at the point where it balances. The ruling is usually with a single red line under the amount on each side of the account.

The illustration at the right shows one form of ruling the account with a charge customer; the same form is applicable to the account with a creditor.

You will observe that when possible, the lines are ruled without moving the ruler, also that when more than one amount is involved in connection with ruling that the two or more amounts are footed

before ruling. Since ruling indicates that the two sides of the account are in balance above the ruling, the pencil figures used in connection with the ruling must be made very small to avoid the possibility of including them in future additions.

Each account with a customer or creditor is footed at the time a Trial Balance is to be taken, which is usually the end of each month. The balance is entered in the explanation column on the larger side; in the case of customers, on the debit side, and creditors, on the credit side. This plan of indicating the balances facilitates the preparation of the Trial Balance. The figures in the explanation column in the illustration above show the amount stated on the March Trial Balance. When subtraction is not necessary to ascertain the account balance, the amount is not entered in the explanation column. See January, February and April balances in the above illustration.

The illustration below shows another form of ruling for an account with a creditor or charge customer. This form is usually used when the account

contains a number of debits and credits and full payment has been made to the creditor or full collection received from the customer. This same form of ruling may be used when it is de-

L. J. Bremer Uniontown

July 1	9	647	Aug. 15	63	75 -
12	23	892		87	3975
27	56	5583	Sept 1	117	2850
Aug 16	89	1421			
29	99	3750			
		14325			14325

sired to balance the account and carry the balance down below the ruling or forward it to a new page. The method of balancing an account, that is, entering the balance on the smaller side so that the two sides will be equal before ruling, is shown in the ruling of the Cash account on page 27.

You will observe that when an account is balanced, the amount required to make it balance is brought down below the ruling on the opposite side or forwarded to a new page. When the account is ruled and the balance carried forward to a new page, the pages in the ledger are written in the folio columns instead of check marks as in the illustration of the Cash account on page 27.

Use of Red Ink. Red ink is used in the illustrations in this text for ruling and for the desired information when it is necessary to make an account balance in order to rule it. The use of red ink, however, is optional with the accountant or the one who keeps the record; black ink is entirely satisfactory for ruling or any other form of office work. It is suggested that you follow the illustrations or the wishes of the instructor while completing this course and the directions of your employer when you do accounting work in an office.

Illustrations. The method of recording transactions in which merchandise is purchased and sold on credit is further explained by illustrations. The illustrations show the transactions completed by J. H. Mann during January, recorded in the journal and posted to the ledger, and the Trial Balance prepared to prove that the equality of debits and credits has been maintained in the ledger. The transactions are as follows:

2. J. H. Mann invested \$1000.00 cash in the flour business.
2. Paid January rent, \$60.00.
2. Purchased from D. A. Crowe, 824 Fourth St., City, 200 bbls. flour, \$1650.00; terms, 10 days.
6. Received cash \$153.75 for sales of flour (15 bbls. at \$10.25).
10. Sold W. A. Locke, 320 Main St., City, 25 bbls. flour at \$10.25; terms, 10 days.
12. Paid D. A. Crowe \$825.00 in cash, on account.
18. Sold W. A. Locke 15 bbls. of flour at \$10.25; terms, 10 days.
20. Received from W. A. Locke \$256.25 in cash for sale of the 10th.
25. Sold M. A. Towne, 416 Park St., City, 35 bbls. of flour at \$10.25; terms, 10 days.
31. Paid \$121.50 for January salaries.

Journal. The journal, Illustration 7 on page 25, contains a record of these ten transactions. As explained, the purpose of the journal is to indicate the accounts debited and credited and the amounts to be posted to these accounts because of transactions completed.

The following comments refer to the entries in the journal and the posting, it being assumed that each entry was posted as soon as it was recorded.

Analysis of Journal Entries. The first entry records the investment. Debits and credits are indicated in the journal by position and transferred to the ledger as indicated. The ledger page is written in the journal to indicate posting and the journal page is written in the ledger for reference.

January 2, 19-

27	Cash	1000 -	
27	J H Mann, Cashier		1000 -
	Investment in the flour business		
27	Expense	60 -	
27	Cash		60 -
	Paid january rent		
27	Purchases	1650 -	
27	D A Crowe, 524 Fourth St. City		1650 -
	Purchased flour on 10 days time		
27	Cash	15375	
27	Sales		15375
	Sold 15 bbls flour @ \$10 ²⁵ for cash		
27	W A Locke, 320 Main St. City	25625	
27	Sales		25625
	Sold 25 bbls flour @ 10 ²⁵ , terms 10 days		
27	D A Crowe	825 -	
27	Cash		825 -
	Paid on account, flour balance of 2 nd		
27	W A Locke	15375	
27	Sales		15375
	Sold 15 bbls flour @ 10 ²⁵ , terms 10 days		
27	Cash	25625	
27	W A Locke		25625
	Received cash in full for sale of 10 th		
27	M A Towne, 416 Park St. City	35875	
27	Sales		35875
	Sold 35 bbls flour @ 10 ²⁵ , terms 10 days		
27	Expense	12150	
27	Cash		12150
	Paid salaries for january		

The second entry records a decrease in assets and proprietorship because of rent paid. Debits and credits are indicated by position in the journal and posted as indicated.

The third entry records a purchase of merchandise on credit. The Purchases account is debited to record the increase in purchases and the account with the creditor is credited to record the liability. Debits and credits are indicated by position in the journal and posted as indicated.

The fourth entry records a cash sale of merchandise. The Cash account is debited to record the increase in the asset cash and the Sales account is credited to record the increase in sales. Debits and credits are indicated by position in the journal and posted as indicated.

The fifth entry records a sale of merchandise on credit. The account with the charge customer is debited to record the increase in the asset accounts receivable and the Sales account is credited to record the increase in sales. Debits and credits are indicated by position in the journal and posted as indicated.

It will be observed in the fourth and fifth entries that the Sales account is credited for cash sales and charge sales. The same account is not debited because in the case of a cash sale the asset cash increases while in the case of a charge sale the asset accounts receivable increases.

The remaining five transactions are entered in the journal and posted to the ledger in the same manner. In each entry the amount is recorded twice and the method of recording provides for proving totals as shown by the Trial Balance on page 28. The equation "Assets = Liabilities + Proprietorship" is used as a basis for determining the debits and credits.

Ledger. The ledger, Illustration 8 on page 27, contains the same information as it relates to account titles and amounts as the journal on page 25. This ledger is the result of posting the journal. The following comments relate to the posting.

Each amount recorded in the left column of the journal is posted to the debit side of the account written on the same line with it. Completion of the posting is indicated by writing the page of the ledger (in this case the page of the text) in the folio column of the journal; and the page of the journal (in this case the page of the text) is written in the folio column of the ledger for reference.

Each amount entered in the right column of the journal is posted to the credit side of the account written on the same line with it. Completion of the posting is indicated by writing the page of the ledger in the folio column of the journal, and the page of the journal in the folio column of the ledger.

The posting is usually completed in the order in which the amounts are recorded in the journal. Some accountants prefer to post all the debits first and then all the credits, but the better plan is to post the amounts in the order stated in the journal.

Cash

10	Jan 2	25	1000 -	Jan 2	25	60 -
	6	25	15375	12	25	825 -
	20	25	25625	31	25	162150
			1410 -			1410 -
Feb 1	Balance	✓	4250			

J. H. Crowe

320 Main St. City

10	Jan 10 11 days	25	25625	19	Jan 20	25	25625
	18 10 days	25	15375				

M. A. Towne

416 Park St. City

9	Jan 25 11 days	25	355 -5				
---	----------------	----	--------	--	--	--	--

D. A. Crowe

524 Fourth St. City

19	Jan 12	25	825 -	19	Jan 2 10 days	25	1650 -
----	--------	----	-------	----	---------------	----	--------

J. H. Mann, Capital

10 Jan 2

25 1000 -

Sales

19 Jan 6

25 15375

10

25 25625

18

25 15375

25

25 35875

Purchases

19 Jan 2

25 1650 -

Expense

19 Jan 2

Rent

25 60 -

31 Salaries

25 12150

Illustration 8, Ledger Resulting from Posting Illustration 7

J. H. Mann
Trial Balance, January 31, 19

27	Cash	403 50		
27	H. A. Lohr	153 75		
27	M. A. Towne	358 75		
27	D. A. Crowe		825 -	
27	J. H. Mann, Capital		1000 -	
27	Sales		922 50	
27	Purchased	1650 -		
27	Expense	181 50		
		2747 50	2747 50	

Illustration 9, Trial Balance

Trial Balance. The Trial Balance, illustrated above, was prepared from the ledger, Illustration 8 on page 27. It contains a list of the open accounts in the ledger with the debit or credit balances written in the left or right columns on the same line with the account title. The purpose of this Trial Balance is to prove that the equality of debits and credits has been maintained when recording the transactions and posting to the ledger. Unless this equality can be proved through the Trial Balance, the asset and liability account balances in the ledger can not be used as a basis for verifying proof of the count.

REPORTS

Three reports are required at this time, Nos. 7, 8 and 9. When No. 7 is completed, present to the instructor for approval and while you are waiting for it to be approved, complete No. 8. When No. 8 is completed, present for approval and complete No. 9. When No. 9 is completed, present for approval and proceed with the text discussion until Report No. 10 is required on page 32.

CHAPTER IV

RECORDING TRANSACTIONS IN SPECIAL JOURNALS

You have doubtless observed that many transactions affect the assets and proprietorship in the same way. This similarity of effect makes possible more efficient methods of recording the transactions. The discussion in this chapter relates to the method of recording transactions in special journals.

Special Journals. While all transactions may be recorded in the one journal, yet it is not customary in business to do this because a more efficient method may be used. When a number of transactions affect the same account in the same way, time can be saved by recording them in a special journal.

The special journals usually used in a mercantile business are (a) *purchases journal*, (b) *sales journal*, (c) *cash receipts journal*, and (d) *cash payments journal*; the cash receipts journal and cash payments journal are usually combined in one book known as the *cash book*. The use of these journals provides a more efficient method of recording transactions. It also provides for a division of the work among the employees of the accounting department.

Purchases Journal. Each purchase of merchandise on credit results in an increase in the purchases and an increase in the liability accounts payable. The entry to record this effect on purchases and liabilities requires a debit to the Purchases account and a credit to the account with the creditor for the amount of each purchase.

The purchases journal is a book of original entry in which all transactions resulting in an increase in purchases and an increase in the liability accounts payable are recorded, and no other transactions are recorded in it. The purpose of this journal is to avoid the necessity of writing the title of the account debited in each transaction and to permit posting the total of the amounts recorded in it to the Purchases account in one amount. The title "purchases journal" is used because the total is to be posted to the Purchases account.

The information required in connection with the record of a purchase of merchandise on credit is obtained from the purchase invoice and includes the following: (a) the date the transaction is recorded, (b) the name and address of the creditor, (c) the terms, (d) the date of the invoice, and (e) the amount of the purchase. The purchases journal is ruled so that each purchase may be recorded on one horizontal line with the desired information contained in columns provided as in Illustration 10 on page 31.

of the seller on the purchase invoice indicates that the invoice has been recorded in the purchases journal. The record of each of the other two invoices is made in the same manner; the basis of information for the record is the printed instructions because the invoices are not illustrated.

PURCHASES JOURNAL

January 19

DATE	L F	ACCOUNT CREDITED	ADDRESS	TERMS	INV DATE	AMOUNT
2	32	E. C. Cline	Chicago		1/1	77.30
3	32	Langley Bros.	32 Main St. City	30 days	1/2	134.95
23	32	Logan & Mosley	Centerville	20 days	1/20	228.60
31	32	Purchases Dr.	Total Purchases			440.85

Illustration 10, Purchases Journal

Posting from the Purchases Journal. Each horizontal line in the purchases journal contains the record of a transaction in which the purchases and the liability accounts payable increase the same amount; the liability is recorded in the name of the creditor. Since the purpose of posting is to record in the ledger the information recorded in the book of original entry, each amount in the amount column is posted to the credit of the account with the creditor written on the same line with it; this posting is usually completed daily. At the end of the month or when a Trial Balance is to be taken, the sum of the amounts in the amount column is ascertained and posted to the debit of the Purchases account.

When posting from the purchases journal, it is customary to indicate the journal from which the amount was posted by writing "P" in connection with the page of the purchases journal in the folio column of the ledger. The purchases journal is ruled at the time the total is posted; the method of ruling and writing the title of the account debited for the total is shown in Illustration 10 above.

The ledger in Illustration 11 shows the posting of the purchases journal, Illustration 10. You will observe that the equality of debits and credits was maintained in the purchases journal and in the ledger. The one debit to the Purchases account equals the sum of the three credits to accounts with creditors.

It is quite evident that an error in addition of the amount column in the purchases journal will affect the equality of debits and credits in the ledger. Thus, if the total of the purchases journal is \$2,145.50 and through an error in addition this total is posted as \$2,245.50, the debit side of the ledger will be \$100.00 larger than the credit side. Because of the possibility of errors in addition, it is customary to verify the addition of the total purchases before posting; in business this verification is usually made with an adding machine.

E. C. Cline Chicago									
19	Jan 2					P 31		77	30
Langley Bros 32 Main St. City									
19	Jan 3	1/2-30 days				P 31		134	95
Logan & Moseley Centerville									
19	Jan 23	1/2-20 days				P 31		228	60
Purchases									
19	Jan 31					P 31		440	85

Illustration 11, Ledger Resulting from Posting the Purchases Journal

Trial Balance. As explained, the Trial Balance is a list of open accounts in the ledger. It is prepared to prove that the debits and credits in the ledger are equal. The illustration at the right shows a Trial Balance prepared from the ledger in Illustration 11 above.

E. B. TAYLOR			
TRIAL BALANCE, January 31, 19...			
32	E. C. Cline.....		77 30
32	Langley Bros.....		134 95
32	Logan & Moseley		228 60
32	Purchases.....	440 85	
		440 85	440 85

REPORTS

Two reports are required at this time, Nos. 10 and 11. When No. 10 is completed, present it to the instructor for approval. While you are waiting for it to be approved, complete No. 11. When No. 11 has been completed and presented for approval, continue with the text discussion until Report No. 12 is required on page 35.

Sales Journal. Each sale of merchandise on credit result, in an increase in the asset accounts receivable and an increase in sales. The entry to record this effect on the assets and sales requires a debit to the account with the charge customer and a credit to the Sales account for each sale.

The sales journal is a book of original entry in which all transactions resulting in an increase in the asset accounts receivable and an increase in the sales are recorded and no other transactions are recorded in it. The purpose of the sales journal is to avoid the necessity of writing the title of the account credited in each transaction and to permit posting the total of the amounts recorded in it to the Sales account in one amount. The title "sales journal" is used because the total is to be posted to the Sales account.

The information required in connection with the record of a sale of merchandise on credit is obtained from the sales ticket and includes the following: (a) the date of the sale which is the date of the transaction, (b) the name and address of the charge customer, (c) the terms, if special, (d) the serial number of the sales ticket, and (e) the amount of the sale. The sales journal is ruled so that each sale may be recorded on one horizontal line with the desired information contained in columns provided as in Illustration 12 on page 34.

Illustration of Sales Journal. Illustration 12 on page 34 contains a record of the sales of merchandise on credit made by E. B. Taylor, a retail grocer, during the month of January as follows:

Jan. 6. Sold A. R. Manley, 106 Elm St., City, merchandise per sales ticket No. 1, illustrated at the right.

The sales ticket in the illustration at the right provides full information regarding the sale of January 6. The sales tickets are numbered serially (beginning with 1) to insure recording each sale. Sales tickets are usually bound in a book and prepared in duplicate by the clerk making the sale. One copy is removed from the book and placed with the package and the other copy is retained for the accounting records. If the copies of the sales tickets used as a basis for the accounting records are not bound in a book, they are assembled in numerical order before they are recorded in the sales journal.

SALES TICKET

E. B. TAYLOR

Fancy Groceries & Provisions

476 Walnut St., Springfield

Date Jan. 6, 1919

Sold to A. R. Manley ✓

Address 106 Elm St., City

Sale No. 1 Terms Cash account

10	1 lb. Arabushe Coffee	2.2	8	—
1	1 lb. White Lily Flour		6	25
			14	25

E. B. Taylor

Clerk

16. Sold Gibson Hotel, 12 E. 4th St., City, sale No. 2, \$57.35; terms, 10 days. This sale is represented by a sales ticket similar in form to the one illustrated on page 33.
17. Sold T. L. Staples, Clinton, sale No. 3, \$50.40; terms, 60 days.
26. Sold A. R. Manley, sale No. 4, \$54.25; terms, on account.

NOTE. Terms "on account" indicate that collection is to be made from the charge customer on or before the first of February as explained on page 22.

Comparing the first entry in the sales journal, Illustration 12, with the sales ticket on page 33, you will observe that all the desired information is recorded on one horizontal line; the nature of this information is described in the printed headings of the columns. The check mark at the right of the name of the charge customer on the sales ticket indicates that the sale has been recorded in the sales journal. The record of each of the other three sales is made in the same manner; the basis of information for the record is the printed instructions because the sales tickets are not illustrated.

SALES JOURNAL						
January 19						
DATE	L. F.	ACCOUNT DEBITED	ADDRESS	TERMS	SALE NO.	AMOUNT
6	35	A. R. Manley	106 Elm St., City		1	14 25
16	35	Gibson Hotel	12 E. 4th St., City	10 days	2	57 35
17	35	T. L. Staples	Clinton	60 days	3	50 40
26	35	A. R. Manley			4	54 25
31	35	Staples Cr.	T. L. Staples			170 25

Illustration 12, Sales Journal

Posting from the Sales Journal. Each horizontal line in the sales journal contains the record of a transaction in which the asset accounts receivable increases and the sales increase the same amount; the asset is recorded in the name of the charge customer. Since the purpose of posting is to record in the ledger the information recorded in the book of original entry, each amount in the amount column is posted to the debit of the account with the charge customer written on the same line with it; this posting is usually daily. At the end of the month or when a Trial Balance is to be taken, the sum of the amounts in the amount column is ascertained and posted to the credit of the Sales account.

When posting from the sales journal, it is customary to indicate the journal from which the amount was posted by writing "S" and the page of the sales journal or the sale number in the folio column of the ledger. The sales journal is ruled at the time the total is posted; the method of ruling and writing the title of the account credited for the total is shown in the illustration.

The ledger in Illustration 13 shows the posting of the sales journal in Illustration 12. You will observe that the equality of debits and credits was maintained in the sales journal and in the ledger. The one credit to the Sales

account equals the sum of the four debits to accounts with charge customers. It is quite evident that an error in the addition of the amount column in the sales journal will affect the equality of debits and credits in the ledger.

A. R. Manley 12 Elm St. City									
9	Jan 6	\$ 1	1425						
	26	\$ 4	5425						
			5425						
Gibson Hotel 12 E. North St. City									
19	Jan 16 10 days	\$ 2	5735						
T. L. Staples Clinton									
19	Jan 17 60 days	\$ 3	5546						
Sales									
	Jan 31	\$ 34	17625						

Illustration 13, Ledger Resulting from Posting the Sales Journal

35

A. R. Manley.....

68

50

35

Gibson Hotel.....

57

35

35

T. L. Staples.....

50

40

35

Sales.....

176

25

176

25

176

25

E. B. TAYLOR

TRIAL BALANCE, January 31, 19...

is to prove the equality of debits and credits in the ledger. As explained in a previous discussion, the Trial Balance is a list of the open accounts in the ledger and is prepared periodically to determine that the sum of the debit account balances in the ledger equals the sum of the credit account balances.

REPORTS

Two reports are required at this time, Nos. 12 and 13. When No. 12 is completed, present it to the instructor for approval and proceed with No. 13. When Report No. 13 has been completed and presented for approval, continue with the text discussion until Report No. 14 is required on page 46.

Cash Book. The cash book is a book of original entry in which all transactions resulting in an increase or a decrease in the asset cash are recorded and no other transactions are recorded in it. Receipts and payments are usually recorded on opposite pages with receipts on the left and payments on the right. The purpose of the cash book is to avoid the necessity of writing the title of the Cash account when recording transactions in which cash is received or paid. The word "Cash" is used in the title of the book because the total receipts is to be posted to the debit of the Cash account and the total payments to the credit of the Cash account.

Cash Receipts. Each transaction in which cash is received results in an increase in the asset cash for the amount of cash received and usually a corresponding decrease in some other asset or an increase in the income. The entry to record the effect on assets or assets and income requires a debit to the Cash account and a credit to some other asset account or an income account.

The information usually required in recording a cash receipt on the receipts side of the cash book includes (a) the date, (b) the name of the account credited, (c) the explanation, that is, the reason the cash was received and (d) the amount of cash received. The receipts side of the cash book is ruled so that each cash receipt may be recorded on one horizontal line and the desired information contained in columns as in Illustration 14 on page 38.

The basis for an entry on the receipts side of the cash book is money received which may be in the form of currency, bank checks, money orders or the various other forms of commercial papers accepted in business as cash. It is customary to deposit the money received in the bank and make payments by check. When this plan is followed, the total of the amount column on the receipts side of the cash book will equal the total amount deposited in the bank during the same period.

Cash Payments. Each transaction in which cash is paid results in a decrease in the asset cash for the amount of cash paid and a corresponding decrease in liabilities, an increase in some other asset or an increase in expense. The entry to record this effect on assets and liabilities or expense requires a credit to the Cash account and a debit to a liability account, an asset account or an expense account for the amount of cash paid.

The information usually required in recording a cash payment on the payments side of the cash book includes (a) the date, (b) the name of the account debited, (c) the explanation, that is, the reason the cash was paid and (d) the amount of cash paid. The payments side of the cash book is ruled so that each cash payment may be recorded on one horizontal line and the desired information contained in columns as in Illustration 15 on page 39.

The basis for an entry on the payments side of the cash book is the check stub from which the check issued for the payment was removed. When the bank has paid all checks issued, the total amount of the paid checks returned by the bank will agree with the total of the amount column on the payments side of the cash book.

Illustration of Cash Book. Illustrations 14 and 15 on pages 38 and 39 contain a record of cash receipts and payments made by E. B. Taylor, a retail grocer, during the month of January. These transactions are as follows:

1. E. B. Taylor invested \$1000.00, cashier's check on the First National Bank, in the retail grocery business.

60-155	
THE FIRST NATIONAL BANK	No. <u>101</u>
YORK, PA.	JANUARY 2 19
***** E. B. TAYLOR *****	
Pay to the order of	\$ 1000.00
ONE THOUSAND - - - - -00/100 DOLLARS	
CASHIER'S CHECK	<i>R. C. Brown</i> CASHIER

4. Paid January rent by check No. 1; see Illustration 21, page 44, for check stub.
10. Paid J. F. Woods for merchandise purchased by check No. 2; see second stub in Illustration 21.
12. Received \$30.50 currency for sundry cash sales. The cash register record would agree with the amount of the currency reported.
13. Gave E. C. Cline check No. 3 for \$77.30 in full of account. This check is shown written in Illustration 21, page 44, but the stub is not illustrated.
18. Received \$29.56 currency for sundry cash sales.
20. Received check for \$10.00 from A. R. Manley.

January 20, 19	No. <u>128</u>
City National Bank	
13-19	
Pay to the order of	\$ 10.00 ✓
Ten and no/100	Dollars
For on account	<i>A. R. Manley</i> By

27. Received check from Gibson Hotel for \$30.50 to apply on account.

30. Received bank draft for \$25.00 from T. L. Staples.

CLINTON

January 29

19

PNB

PRIMARY NATIONAL BANK

The Public National Bank

PAY TO THE ORDER OF

E. B. Taylor

\$25.00

Twenty-five and 00/100

Dollars

C. M. Murray

CASHIER

30. Received currency \$41.85 for sundry cash sales.

The investment check, illustrated on page 37, is recorded in the first entry on the receipts side of the cash book, Illustration 14, below. All the desired information is recorded on one horizontal line in the appropriate columns as described by the printed headings. The check mark at the right of the amount on the check indicates that it has been recorded. This first entry records an increase in the asset cash and an increase in the proprietorship.

The cash payment shown by check stub No. 1, Illustration 21, page 44, is recorded in the first entry on the payments side of the cash book, Illustration 15, page 39. All the desired information is recorded on one horizontal line in the appropriate columns as described by the printed headings. The check mark at the right of the name of the account to be debited on the check stub indicates that the payment has been recorded.

The record of each of the other transactions on the receipts and payments sides of the cash book may be verified with the papers illustrated or with the statement of the transaction.

CASH

					RECEIPTS	
DATE	L F	ACCOUNT CREDITED	EXPLANATION	AMOUNT	TOTALS	
Jan 2	40	E. B. Taylor Capital	Investment	1000 -		
12	40	Sales	Cash sales	3050		
18	40	Sales	Cash sales	2956		
20	40	A. R. Manley	On account	10 -		
27	40	Libson Hotel	On account	3050		
30	40	T. L. Staples	On account	25 -		
31	40	Sales	Cash sales	4185		
31	40	Cash Sales	Total Receipts	116741		116741
Feb 1	1	Balance on hand				84811

Illustration 14, Receipts Side of the Cash Book

Proving Cash. It is customary to prove cash before posting or depositing the money in the bank. Cash is proved by (a) adding the amount column on the receipts side, (b) writing the total in small pencil figures, (c) adding the amount column on the payments side and (d) writing the total in small pencil figures. The amount stated in pencil figures on the receipts side less the amount stated in pencil figures on the payments side equals the bank balance if all the money has been deposited. If all the money has not been deposited, the difference between the two sides of the cash book equals the bank balance plus the cash on hand; see small figures in Illustrations 14 and 15 on pages 38 and 39 for position of totals.

Posting from the Cash Book. Each amount in the amount column on the receipts side is posted to the credit side of the account in the ledger written on the same line with it; this posting is usually completed daily. Each amount in the amount column on the payments side of the cash book is posted to the debit side of the account in the ledger written on the same line with it; this posting is usually completed daily. At the end of the month or when a Trial Balance is desired, the total receipts, after proving cash, are posted to the debit of the Cash account and the total payments to the credit of the Cash account.

When posting from the cash book, it is customary to indicate the journal in the folio column of the ledger through writing "C" in connection with the page of the cash book. The cash book is ruled at the time the totals are posted and the balance is carried down below the ruling; the method of ruling the cash book, writing the titles of the accounts to which the totals are posted, and carrying the balance down is shown in Illustrations 14 and 15.

The ledger in Illustration 16 contains the same information as the cash book in Illustrations 14 and 15. You will observe that the equality of the debits and credits was maintained when posting from the receipts side and the payments side. The debit to the Cash account equals the sum of the credits to the other accounts and the credit to the Cash account equals the sum of the

CASH

				PAYMENTS	
DATE	L. F.	ACCOUNT DEBITED	EXPLANATION	AMOUNT	TOTALS
Jan. 4	40	Expense	January rent	50 -	
10	40	Purchases	Cash purchase	192 -	
13	40	E. C. Cline	For full of account	377.30	
31	40	Cash Cr.	Total Payments		31930
					116741

Illustration 15, Payments Side of the Cash Book

debits to the other accounts. Errors in addition of the amount columns on either side will affect the equality of debits and credits. Errors in addition of the cash book will, however, usually be detected when proving cash.

Cash

¹⁹ Jan. 31	bal. C 38	1167.41	¹⁹ Jan. 31	C 39	3193.0
--------------------------	-----------	---------	--------------------------	------	--------

G. R. Manley

			¹⁹ Jan. 20	C 38	1.0 -
--	--	--	--------------------------	------	-------

Gibson Hotel

			¹⁹ Jan. 27	C 38	305.0
--	--	--	--------------------------	------	-------

T. L. Staples

			¹⁹ Jan. 30	C 38	25 -
--	--	--	--------------------------	------	------

E. C. Cline

¹⁹ Jan. 13	C 39	773.0			
--------------------------	------	-------	--	--	--

E. B. Taylor Capital

			¹⁹ Jan. 1	C 38	1000 -
--	--	--	-------------------------	------	--------

Drills

			¹⁹ Jan. 12	C 38	30.50
			18	C 38	29.56
			30	C 38	141.85

Purchased

¹⁹ Jan. 10	C 37	192 -			
--------------------------	------	-------	--	--	--

Expense

¹⁹ Jan. 4 Rent	C 39	50 -			
------------------------------	------	------	--	--	--

Illustration 16, Ledger Resulting from Posting the Cash Book

E. B. TAYLOR
TRIAL BALANCE, JANUARY 31, 19...

40	Cash.....	848	11		
40	A. R. Manley.....			10	—
40	Gibson Hotel.....			30	50
40	T. L. Staples.....			25	—
40	E. C. Cline.....	77	30		
40	E. B. Taylor, Capital...			1000.	—
40	Sales.....			101	91
40	Purchases.....	192	—		
40	Expense.....	50			
		1167	41	1167	41

Depositing Money in the Bank. It is customary in business to deposit the money received in the bank. It may be necessary sometimes to pay some

DEPOSITED FOR		
<i>E. B. Taylor</i>		
NAME		
<i>476 Walnut St.</i>		
ADDRESS		
IN THE		
MERCHANTS NATIONAL BANK		
<i>January 31, 19</i> ALL CHECKS, NOTES AND DRAFTS CREDITED, SUBJECT TO ACTUAL COLLECTION		
PLEASE LIST EACH CHECK SEPARATELY		
	Dollars	Cents
<i>SPECIE</i> _____		<i>91</i>
<i>BILLS</i> _____	<i>101</i>	—
<i>CHECKS</i> <i>13-19</i>	<i>10</i>	—
" <i>13-15</i>	<i>30</i>	<i>50</i>
" <i>1-12</i>	<i>25</i>	—
Total \$	<i>167</i>	<i>41</i>

See that All Checks And Drafts Are Endorsed

Illustration 17, Deposit Tickets

of the money received before a deposit is made but it is preferable to deposit all the money in the bank, and make the payments by check.

A *depositor* or *customer* of a bank is one who through approval of an officer of the bank deposits money or *cash items* (any commercial paper which the bank will accept as cash) in the bank. When funds are deposited, the depositor prepares a deposit ticket showing the nature and amount of the funds deposited. The deposit tickets in the illustration on page 41 are those which would have accompanied the two deposits made by E. B. Taylor when the cash recorded on the receipts side of the cash book (page 38) was deposited on January 1 and 31.

The cashier's check (page 37) accompanied the deposit ticket at the left, on page 41; the checks (page 37), bank draft (page 38), and the currency received for cash sales January 12, 18 and 30 accompanied the deposit ticket at the right. Each check is listed separately with the American Bankers Association numbers given to indicate the bank on which the check is payable. These numbers are shown on each check; see figures in the upper right hand corner of the check at the top of page 37. Some banks request the depositor to write the name of the local banks and the city for out of town banks instead of the A. B. A. number.

Indorsement. Each check is made payable to E. B. Taylor, hence it will be necessary for him to transfer title to the check by indorsement at the time the deposit is made. The usual form of indorsement for deposit is shown in Illustration 18 below. This illustration shows the back of the cashier's check illustrated on page 37. The position of the indorsement can very easily be determined by comparing the two illustrations.

As you have learned in commercial law, an indorsement is any writing on the back of a paper for the purpose of transferring title. The indorsement

<i>Pay to the order of</i> <i>Merchants Natl Bank</i> <i>For Deposit</i> <i>E. B. Taylor</i>	60-155	
	VAL BANK No. 115	
	PA.	JANUARY 2 19
	OR *****	\$ 1000.00
	-----00/100 DOLLARS	
	R. C. Brown CASHIER	

Illustration 18, Position of Indorsement

deposit ticket or an entry in the *pass book*. Each entry in the pass book is made by an official of the bank, hence the pass book provides the depositor with a receipt for all cash deposited in the bank by him. A depositor should present his pass book with each deposit so that the official may enter therein the date and amount of the deposit.

The illustration on page 43 shows the usual ruling for a pass book and the method of recording the deposit in it by an official of the bank. The two deposits entered are those made by E. B. Taylor January 1 and 31. Usually no entries are made in the pass book except those for deposit.

Withdrawing Money from the Bank. The depositor withdraws money which he has deposited in the bank through a written order known as a *check*. No standard form is necessary, but for the convenience of the depositor and the employees of the bank, it is customary for the bank to provide the depositor with printed forms usually referred to as *blank checks*. These blank checks are usually bound in a book with a stub attached to each. The depositor uses the blank check for writing his order on the bank and the stub for his record of the payment. Space is provided on the check and on the stub for a number. The depositor should number each check and its corresponding stub with the same number, arranging the numbers consecutively, beginning with the first check issued.

Brought Forward Deposit Jan. 1 1000 Balance,		No. 3 January 19 19 Merchants National Bank Pay to the order of Twenty Dollars \$ 20 on current account By E. B. Taylor
No. 1 Date January 16 19 \$ 50.00 Favor Allen & Co. For January rent Account Expended ✓		
Balance, . . . 950 Deposit, . . . Balance, . . .		
No. 2 Date January 30 19 \$ 19.25 Favor J. J. Woods For Cash, out of Mdse. Account Purchases ✓		
Carried Forward 758		No. 19 19 Merchants National Bank Pay to or order Dollars By
No. 3 Date January 10 19 \$ 19.25 Favor J. J. Woods For Cash, out of Mdse. Account Purchases ✓		
Balance, . . . 950 Deposit, . . . Balance, . . .		
No. 4 Date January 10 19 \$ 19.25 Favor J. J. Woods For Cash, out of Mdse. Account Purchases ✓		

Illustration 21, Check Book

Illustration 21 shows a check book with two checks to the page. Three checks have been issued. Nos. 1 and 2 have been detached from the stub and each given to the payee; No. 3 has not yet been detached from the stub. Thus, the illustration shows the method of writing both the check and the

stub; you may assume that the information on the stub of check No. 3 is the same as that on checks Nos. 1 and 2 in so far as it relates to a record of the facts stated in the check.

You will observe from the illustration that E. B. Taylor has kept a record on the check stub of the amount of money in the bank. Each check is subtracted from the balance in the bank at the time it is written and each deposit added to the last balance at the time the deposit is made.

Bank Statement. It is customary with banks to render to each depositor on the first of the month a statement showing the balance on deposit at the end of the preceding month. This statement will be accompanied by the canceled checks, that is, those checks which have been paid by the bank.

The illustration below shows the statement received by E. B. Taylor from the Merchants National Bank on the first of February. This statement shows the amount of each deposit and the amount of each check paid.

E. B. TAYLOR IN ACCOUNT WITH			
THE MERCHANTS NATIONAL BANK			VOUCHERS RETURNED 2
REPORT PROMPTLY ANY CHANGE IN YOUR ADDRESS			
DATE	CHECKS IN DETAIL	DATE	DEPOSITS
BALANCE BROUGHT FORWARD			
Jan. 6	50.00 -		\$1000.00
12	192.00 -		167.41
BALANCE			\$ 925.41

Illustration 22, Bank Statement

Reconciliation of the Bank Account. The depositor's record of the money in the bank will not always agree with that on the bank statement because all the checks issued by the depositor may not have been presented to the bank for payment by it. The depositor should *reconcile* his bank balance with that shown on the bank statement at the time the statement is received.

The balance in the bank as shown by the record on the check stub should be the same as the amount in the bank after all checks issued have been paid. If the bank balance on the statement is more than the balance on the check

stub, the sum of the checks issued but not paid subtracted from the balance shown by the bank statement should show the same amount as the balance on the check stub.

Comparing the bank statement, Illustration 22, with the check stub, Illustration 21, it will be observed that three checks have been issued but only two presented for payment. The bank balance on the check stub, after deducting check No. 3, and adding the deposit of December 31, \$167.41, is \$848.11. The bank balance on the statement is \$925.41. The amount of check No. 3 is \$77.30. Bank balance $\$925.41 = \$77.30 + \$848.11$.

General Journal. Those transactions which because of their nature can not be recorded in a special journal are recorded in the journal. To avoid confusion when referring to the journals, it is customary to describe the journal as the *general journal*. Thus, purchases on credit are recorded in the purchases journal, sales on credit in the sales journal, cash receipts and payments in the cash book, and all other transactions in the general journal.

The ruling in the general journal is the same as that in the journal, Illustration 5, unless transactions to be recorded require additional columns in order to record them in a more efficient manner. The posting from the general journal is the same as described and illustrated on page 17. The letter "J" is usually written in connection with the page in the folio column of the ledger to indicate the journal from which the amount was posted.

REPORTS

Two reports are required, No. 14 relates to the cash book and No. 15 relates to all of the books of original entry discussed in this chapter. Compare the business forms in connection with Report No. 14 with the discussion of business forms on pages 41-45 before beginning the exercises. Also give attention to the transactions and business forms on pages 37 and 38. It is essential that you understand the meaning of the business forms because each paper in Report No. 14 represents a transaction to be recorded.

While you are waiting for Report No. 14 to be approved by the teacher, complete Report No. 15. Report No. 15 provides practice in posting from the four special journals and preparing a Trial Balance. Special journals provide short-cut methods for recording the changes in assets, liabilities and proprietorship because of transactions completed. The method of recording the transactions in special journals is given emphasis in Reports 10-14; the method of recording the same information in the ledger and proving the equality of debits and credits in the ledger is emphasized in Report No. 15.

When Report No. 15 has been completed and presented for approval, continue with the text discussion until Report No. 16 is required on page 62.

CHAPTER V

A MODEL SET

The books of original entry and ledger contain a record of all the transactions completed by a business and are usually referred to as a *set of books*. The illustrations in this chapter show the set of books belonging to W. A. Gordon, a retail merchant, and contain a record of the transactions completed by him during the months of September and October as stated in the narrative.

Clerical Work. The clerical work usually required in the accounting department consists of (a) verifying and recording purchases, (b) preparing invoices for sales and recording sales, (c) recording cash received, (d) writing checks and recording them, (e) proving cash, (f) posting from the journals, (g) preparing monthly Trial Balance, (h) preparing the monthly statements.

The number of clerks required to do this clerical work will depend entirely upon the number of transactions completed. Whether one or more clerks are required, the work of each must be proved, the accounting records being used as a basis of the proof. Calculating machines are usually used for verifying extensions in invoices since there is no means of proving the correctness of these through the accounting records.

The clerical work in connection with recording transactions is frequently referred to as bookkeeping and the one who records the transactions is referred to as a bookkeeper. With the growth of larger units in business, the work formerly done by one bookkeeper is performed by numerous clerks, such as entry clerk, accounts receivable ledger clerk, cashier, etc. As explained in the preface, accounting is a broader term and includes all phases of clerical work in the accounting department, the method of proof, and the information to be provided by all the accounting records.

Keep in mind the fact that no matter what phase of clerical work you may be called upon to do in the accounting department of an office that your work in some way forms a part of the accounting records from which the reports needed by the owner or executives will be prepared. With a knowledge of accounting, you have every opportunity of advancing from a clerical position to one of greater importance; if you do not know accounting, you can not hope to be more than a clerical worker in the accounting department.

NARRATIVE OF SEPTEMBER TRANSACTIONS

1. W. A. Gordon began the operations of a retail business September 1 with a cash investment of \$1,000.00 and merchandise in stock, \$500.00.

Posted the investment recorded in the cash book and general journal. The ledger is on pages 58 to 61; see index on page 57.

PURCHASES JOURNAL

PAGE 1

September 19-

DATE	L. F.	ACCOUNT CREDITED	ADDRESS	TERMS	INV. DATE	AMOUNT
2	12	Brown Bros.	820 Park St., City	Net Cash	9/1	79.30
3	13	King & King	16 York St., City	10 days	9/2	136.95
5	12	Brown Bros.		Net Cash	9/4	194.00
6	12	Brown Bros.		10 days	9/5	230.00
15	12	Brown Bros.		10 days	9/3	225.00
17	14	Lake View Creamery	Dayton	10 days	9/5	30.00
22	12	Brown Bros.		10 days	9/22	199.00
24	13	King & King		10 days	9/27	127.65
30	22	Purchases Dr.	Total Purchases			1292.85
October						
1	15	Duck, McMillan & Co	St. Louis	10 days	10/2	381.75
15	14	Lake View Creamery		10 days	10/3	45.00
16	12	Brown Bros.		10 days	10/5	216.50
20	13	King & King		10 days	10/8	127.65
24	15	Duck, McMillan & Co		15 days	10/23	117.50
27	16	Dawson Bros. & Co	Lebanon	10 days	10/25	307.50
28	13	King & King		10 days	10/27	141.37
31	22	Purchases Dr.	Total Purchases			1340.75

Illustration 23, Purchases Journal, Page 1

2. Bought from Brown Bros., 820 Park St., City, merchandise, invoice dated 9/1, \$79.30; terms, net cash.
See Illustration 23, above, for the entry and the illustration on page 30 for the form of purchase invoice. The terms "net cash" indicate that check is to be sent as soon as the merchandise is received.
3. Bought from King & King, 16 York St., City, merchandise, invoice dated 9 2, \$136.95; terms, 10 days.
See second entry in the purchases journal, Illustration 23.
4. Gave W. A. Rule check for \$65.00, September rent.
See Illustration 26, page 53, for the entry and Illustration 21, page 44, for the form of check and stub. The title of the account indicates that W. A. Gordon wishes to know the expense because of rent separate from the other expenses.
5. Sold A. Y. Jordan, 115 Main St., City, sale No. 1, \$16.25; terms, 10 days.
See Illustration 24, page 49, for the entry and the illustration on page 33 for the form of sales ticket.
Bought from Brown Bros., merchandise, invoice dated 9/4, \$194.00; terms, net cash.
6. Received \$32.00 for sundry cash sales to date.
See second entry on the receipts side of the cash book, Illustration 25, page 52.
Gave Brown Bros. check for \$79.30, in full for purchase of the 2d.
See second entry in Illustration 26.

8. Sold People's Hotel, 165 Willis St., City, sale No. 2, \$59.35; terms, weekly.

See second entry in Illustration 24 below. The terms indicate collection is to be made at the end of each week.

Gave Brown Bros. check for \$194.00, in full of account.

The explanation "In full of account" is used to describe a payment or collection which when posted will balance the account with the creditor or customer.

9. Received check from A. Y. Jordan for \$10.00 to apply on sale of 9 5.

See third entry in Illustration 25.

10. Bought from Brown Bros., merchandise, invoice dated 9 9, \$230.00; terms, 30 days.

The terms here indicate that the prompt payment of the other two purchases has made it possible for W. A. Gordon to buy from Brown Bros. on more liberal terms.

11. Sold A. Y. Jordan, sale No. 3, \$56.25; terms, 60 days.

12. Received from People's Hotel check for \$30.50 to apply on account.

13. Received \$40.00 for sundry cash sales to date.

SALES JOURNAL

PAGE 1

September, 19

DATE	L F	ACCOUNT DEBITED	ADDRESS	TERMS	SALE NO	AMOUNT
5	2	A. Y. Jordan	115 Main St., City	60 days	1	16 25
8	3	People's Hotel	165 Willis St., City	Weekly	2	59 35
11	2	A. Y. Jordan		60 days	3	56 25
13	4	W. C. Burns	Kingston		4	54 40
16	3	People's Hotel			5	51 40
19	5	James C. Wells	416 Broad St., City	20 days	6	44 30
22	6	James C. Wells	765 E. 9th St., City	10 days	7	26 05
25	3	People's Hotel			8	82 05
26	6	James C. Wells		20 days	9	44 25
27	3	People's Hotel			10	80 25
30	5	James C. Wells		20 days	11	37 56
30	21	Sales Cr	Total Sales			552 11
October 19						
4	7	J. C. Taylor	3752 Crescent Ave., City	30 days	12	132 55
6	3	People's Hotel		30 days	13	142 50
8	2	A. Y. Jordan		30 days	14	38 50
10	2	A. Y. Jordan			15	42 50
13	3	People's Hotel			16	92 90
15	4	W. C. Burns		10 days	17	45 75
17	7	J. C. Taylor		30 days	18	86 42
		Carried Forward				581 12

Illustration 24, Sales Journal, Page 1

SALES JOURNAL

PAGE 2

October 19

DATE	L. F.	ACCOUNT DEBITED	ADDRESS	TERMS	SALE NO.	AMOUNT
		<i>Brought forward</i>				581.12
21	5	<i>James O. Wills</i>			19	51.40
22	7	<i>J. C. Taylor</i>			20	55.40
23	3	<i>People's Hotel</i>		<i>30 days</i>	21	162.25
25	5	<i>James O. Wills</i>		<i>Weekly</i>	22	38.65
27	4	<i>W. O. Burns</i>			23	12.50
28	3	<i>People's Hotel</i>			24	116.65
29	8	<i>Robert E. Cowan</i>	<i>3175 Turner Ave, City</i>	<i>10 days</i>	25	6.83
31	21	<i>Sales Cr.</i>	<i>Total Sales</i>			1079.80

Illustration 24, Sales Journal, Page 2

13. Gave King & King check for \$100.00 to apply on account.
Sold W. O. Burns, Kingston, sale No. 4, \$54.40.
15. Bought from Brown Bros., merchandise, invoice dated 9 13, \$248.00.
Proved cash (balance, \$674.20), deposited all checks and currency and posted the four journals (see pages 58-61).
16. Sold People's Hotel, sale No. 5, \$51.40.
17. Bought from Lake View Creamery, Dayton, merchandise, invoice dated 9/15, \$30.00; terms, 20 days.
18. Received from W. O. Burns check for \$35.00 to apply on sale of 9 13.
19. Sold James O. Wills, 416 Broad St., City, sale No. 6, \$44.30; terms, 20 days.
The People's Hotel returned one barrel flour purchased on the 16th.
Allowed credit for \$9.10, the sale price.
20. Gave King & King check for \$36.95 in full of account.
Received \$65.00 for sundry cash sales to date.
22. Sold James C. Wells, 765 E. 9th St., City, sale No. 7, \$26.05; terms, 10 days.
23. Bought from Brown Bros., merchandise, invoice dated 9 22, \$199.10; terms, 10 days.
24. Received credit from Brown Bros. for \$12.60, 3 cases of canned peaches at \$4.20, purchased on the 10th and returned by agreement.
Received check from People's Hotel for \$15.00 to apply on account.
25. Sold People's Hotel, sale No. 8, \$82.05.
26. Received from A. Y. Jordan, \$6.25 in full for sale of the 5th.
Sold James C. Wells, sale No. 9, \$44.25; terms, 20 days.
27. Sold People's Hotel, sale No. 10, \$80.25.
Received \$48.50 for sundry cash sales to date.

29. Bought from King & King, merchandise, invoice dated 9 27, \$174.75; terms, 10 days.

Received from People's Hotel check for \$65.00 to apply on account.

30. Gave Brown Bros. check for \$150.00 to apply on purchase of the 15th. Sold James O. Wills, sale No. 11, \$37.56; terms, 20 days.

Gave the bookkeeper check for \$75.00, September salary.

Gave the telephone company check for \$4.00, September telephone service.

Proved cash (balance \$643.00), deposited all checks, ruled the cash book and posted it including the totals.

Posted the purchases journal, footed and ruled it, and posted the total.

Posted the sales journal, footed and ruled it, and posted the total.

Posted the general journal.

Took a Trial Balance (see page 62) and checked the books of original entry to detect an error because the Trial Balance did not balance.

Prepared monthly statements for charge customers.

STATEMENT			
W. A. GORDON GROCERIES AND PROVISIONS 109 W. Third Street Cincinnati			
			Date <u>Sept 30 19</u>
To <u>W. O. Burns</u>			
<u>Kingston</u>			
	Balance		
<u>Sept 15</u>	Merchandise per bill rendered	<u>174.75</u>	
	<u>25</u>		
<u>Sept 25</u>	Cash	<u>65.00</u>	
			<u>9.40</u>

STATEMENT			
LAKE VIEW CREAMERY MANUFACTURERS HIGH GRADE BUTTER DAYTON			
			September 30, 19
TO Mr. W. A. Gordon 109 W. Third St. Cincinnati, Ohio			
DATE	CHARGES	CREDITS	BALANCE
SEP 15-	3 0 0 0		3 0 0 0 ₹

The statement at the left was mailed to W. O. Burns by W. A. Gordon and the statement at the right was mailed to W. A. Gordon by Lake View Creamery. Compare these statements with the accounts on pages 58 and 60.

NARRATIVE OF OCTOBER TRANSACTIONS

- Gave W. A. Gordon check for \$100.00 for personal use; see page 14.
Gave W. A. Rule check for \$65.00, October rent.
Bought from Dick, McMillan & Co., Springfield, merchandise, invoice dated 9/30, \$381.78; terms, 15 days.
- Received check from James C. Wells for \$50.00 to apply on account.
He stated that the debit of September 30 for \$37.56 should not appear in his account. Upon investigation it was found that this debit occurred through error in debiting James C. Wells instead of James O. Wills when posting sale No. 11. Corrected the error; see page 59.

- 2. Gave the Central Transfer Co. check for \$2.25 for freight and drayage on merchandise purchased.
- 3. Received check from People's Hotel for \$100.00 to apply on account.
Gave Brown Bros. check for \$199.10 in full for purchase of September 23.
- 4. Sold J. C. Taylor, 3752 Crescent Ave., City, sale No. 12, \$132.55; terms, 30 days.
Received \$87.65 for sundry cash sales to date.
- 6. Paid Mrs. W. B. Scott \$2.50 in currency for 2 brooms which she bought and paid for on the 4th and returned to us per agreement.
Sold People's Hotel, sale No. 13, \$142.50; terms, 30 days.
- 7. Received check from James O. Wills for \$50.00 to apply on account.
Gave Lake View Creamery check for \$30.00 in full of account.
- 8. Sold A. Y. Jordan, sale No. 14, \$38.50; terms, 30 days.

CASH

PAGE 1

RECEIPTS

DATE	L. F.	ACCOUNT CREDITED	EXPLANATION	AMOUNT	TOTALS
Sept 1	18	W. G. Gordon Capital	Investment	1000 -	
6	21	Sales	Cash sales	32 -	
9	2	A. Y. Jordan	Trappin sale of Sept 5	10 -	
12	3	People's Hotel	On account	30 50	
13	21	Sales	Cash sales	142 50	
18	4	W. O. Burne	Trappin sale of Sept 3	35 -	
20	21	Sales	Cash sales	65 -	
24	3	People's Hotel	On account	15 -	
26	2	A. Y. Jordan	In full for sale of Sept 5	62 5	
27	21	Sales	Cash sales	48 50	
29	3	People's Hotel	On account	156 50	
30	1	Cash Dr	Total Receipts		1347 25
					1347 25
Oct 1	✓	Balance	On hand		643 -
2	6	James C. Hille	On account	50 -	
3	3	People's Hotel	On account	100 -	
4	21	Sales	Cash sales	87 65	
7	5	James C. Hille	On account	50 -	
11	4	W. O. Burne	In full of account	1940	
11	21	Sales	Cash sales	10980	
15	3	People's Hotel	On account	450 55	
		Carried Forward		46685	643 -

Illustration 25, Receipts Side of Cash Book, Page 2

9. Gave King & King check for \$174.75 in full of account and Brown Bros. \$200.00 to apply on purchase of September 10.
10. Sold A. Y. Jordan, sale No. 15, \$42.50.
11. Received check from W. O. Burns for \$19.40 in full of account.
Received \$109.80 for sundry cash sales to date.
13. Gave Walter Dodge check for \$18.50, cost of repairs made by him in the office.
13. Sold People's Hotel, sale No. 16, \$92.90.
15. Bought from Lake View Creamery, merchandise, invoice of October 13, \$48.00; terms, 20 days.
Received check from People's Hotel for \$50.00 to apply on account.
Sold W. O. Burns, sale No. 17, \$45.75; terms, 10 days.
Proved cash (balance \$317.75) and posted from the four books of original entry (see pages 58-61).

CASH

PAGE 3

					PAYMENTS	
DATE	L F	ACCOUNT DEBITED	EXPLANATION	AMOUNT	TOTALS	
Sept 23		Rent Expense	September rent	65 -		
6	12	Brown Bros	in full for pur of Sept 2	79 30		
8	12	Brown Bros	in full of account	194 -		
13	13	King & King	On account	199 50		
20	13	King & King	in full of account	369 50		
30	12	Brown Bros.	To apply on pur of Sept 15	150 -		
30	24	Salary Expense	Bookkeeper's salary	75 -		
30	25	General Expense	Telephone service	70 42 50		
30	1	Cash Cr	Total Payments		704 25	
					1347 25	
Oct 1	19	W. A. Gordon, Drawing	For personal use	100 -		
1	23	Rent Expense	October rent	65 -		
2	22	Purchases	Freight and drayage	2 25		
3	12	Brown Bros.	In full for pur of Sept 23	199 10		
6	21	Sales	Merch. returned	2 50		
7	14	Lake View Creamery	In full of account	30 -		
9	13	King & King	In full of account	174 75		
9	12	Brown Bros.	To apply on pur of Sept. 10	200 -		
13	25	General Expense	Repairs in office	18 50		
Carried Forward				792 10		

Illustration 26, Payments Side of Cash Book, Page 3

CASH

PAGE 4

				RECEIPTS	
DATE	L. F.	ACCOUNT CREDITED	EXPLANATION	AMOUNT	TOTALS
		Brought Forward		466 85	643 -
Oct 18 21		Sales	Cash sales	129 50	
21 25		General Expense	Sold stamps	50	
22 1		People's Hotel	In full for sales in Sept.	3 45	
23 4		W. O. Burns	On account	25 -	
25 6		James C. Wills	In full of account	20 30	
27 21		Sales	Cash sales	136 45	
29 3		People's Hotel	On account	50 -	
30 2		A. Y. Jordan	In full for sale of Sept 11	56 25	
31 7		J. C. Taylor	On account	150 -	
31 21		Sales	Cash sales	187 19	
31 1		Cash Dr.	Total Receipts		1125 49
					1768 49
Nov 1	✓	Balance	On hand		416 61

Illustration 25, Receipts Side of Cash Book, Page 4

16. Bought from Brown Bros., merchandise, invoice 10 15, \$216.50; terms, 30 days.
Gave Dick, McMillan & Co. check for \$381.78 in full of account.
17. Sold J. C. Taylor, sale No. 18, \$86.42; terms, 30 days.
Paid \$5.00 currency for postage stamps.
18. Gave Brown Bros. check for \$98.00, balance due on purchase of 9 15.
Received \$129.50 for sundry cash sales to date.
20. Bought from King & King, merchandise, invoice dated 10 18, \$127.65; terms, 30 days.
Discovered an error of \$10.00 in the calculations for the purchase from Brown Bros. on October 16 and received instructions from them to debit their account with this amount.
21. Sold James O. Wills, sale No. 19, \$51.40.
Received 50c for stamps sold; credited General Expense.
22. Received from People's Hotel \$3.45 in full for all sales in September less credits in September and October.
Sold J. C. Taylor, sale No. 20, \$55.40.
23. Received check from W. O. Burns for \$25.00 to apply on account.
Sold People's Hotel, sale No. 21, \$162.25; terms, 30 days.
24. Gave A. Y. Jordan credit for \$3.75, two hams sold him on the 10th and returned by him.

CASH

PAGE 5

				PAYMENTS	
DATE	L F	ACCOUNT DEBITED	EXPLANATION	AMOUNT	TOTALS
10 16	15	Debit to Wills		172 10	
10 17	25	Bought from Dick, McMillan & Co.	in full of account	38 178	
10 17	25	General Expense	Postage stamps	5 -	
10 18	12	Brown Bros	in full for par of slips	95 -	
31 24		Salary Expense	Bookkeeper's salary	1375 58	
31 1		Cash Cr.	Total payments		1351 88
31 1		Balance			
					1768 49

Illustration 26, Payments Side of Cash Book, Page 5

24. Bought from Dick, McMillan & Co., merchandise, invoice 10 23, \$117.90; terms, 15 days.
25. Sold James O. Wills, sale No. 22, \$38.65; terms, weekly.
Received from James C. Wells \$20.30 in full of account.
27. Received \$136.45 for sundry cash sales to date.
Bought from Dawson Bros. & Co., Lebanon, merchandise, invoice 10 25, \$307.55; terms, 30 days.
Sold W. O. Burns, sale No. 23, \$12.50. Shipped the package by parcel post and debited his account with 60c, the required amount of postage.
Recorded the sale in the sales journal and the stamps in the general journal.
28. Sold People's Hotel, sale No. 24, \$116.65.
Bought from King & King, merchandise, invoice 10 27, \$141.37; terms, 30 days.
29. Received check from People's Hotel for \$50.00 to apply on account.
Sold Robert E. Cowan, 3175 Burnet Ave., City, sale No. 25, \$61.83; terms, 10 days.
30. Received check from A. Y. Jordan for \$56.25, the balance due on sale of September 11.
31. Received check from J. C. Taylor for \$150.00 to apply on account.
Received \$87.19 for sundry cash sales to date.
Gave the bookkeeper check for \$75.00, October salary.

31. Proved cash (balance \$416.61), ruled the cash book, carried the balance down and posted the cash book entries including the totals.

Footed and ruled the purchases journal and posted it including the total.

Footed and ruled the sales journal and posted it including the total.

Posted the general journal.

Prepared a Trial Balance; no check marks in the journals or ledger indicate that the Trial Balance balanced without having to check the posting.

September 1, 19-

10	Merchandise Inventory	500	-		
18	W. A. Gordon, Capital			500	-
	Merchandise on hand at the beginning of business				
	19				
21	Sales	9	05		
3	People's Hotel			9	05
	Allowed credit for 1 barrel flour returned, sold September 16				
	24				
12	Brown Bros.	12	68		
22	Purchases			12	68
	Received credit for 3 cases peaches returned @ \$4.29 purchased Sept 10				
	October 20				
12	Brown Bros.	10	-		
22	Purchases			10	-
	To correct error in purchase invoice of October 16				
	24				
21	Sales	3	75		
2	A. Y. Jordan			3	75
	Allowed credit for 2 hams returned sold October 10				
	27				
4	W. O. Burns	60			
25	General Expense			60	
	Postage, Sale 2, 23				

Illustration 27, General Journal, Page 1

Opening a New Ledger. When accounts are opened in a new ledger, it is customary to group and arrange them in the following order:

- (1) Assets
- (2) Liabilities
- (3) Proprietorship
- (4) Income
- (5) Expense

The accounts in the ledger on pages 58-61 are arranged in the order suggested. The account with Merchandise Inventory is in the asset division because it was an asset September 1.

Ledger Pages. Usually a full page is allowed for each account. In the ledger illustrated, it is necessary to group several accounts on each page in the text but each account is given a separate page in the ledger as indicated by the printed number in each account. Thus, Cash is on page 1, A. Y. Jordan, page 2, People's Hotel, page 3, etc.

Partial Payments. Letters are used in personal accounts to enable the bookkeeper to interpret the relation between debit and credit entries without referring to the book of original entry. Thus, "a" opposite amounts on each side of an account indicates that these amounts are related to each other.

The same letter on each side of an account with a creditor indicates that the debit amount is applicable to the credit amount. The same letter on each side of an account with a customer indicates that the credit amount is applicable to the debit amount.

Indexing the Ledger. When the ledger is a bound book or a loose-leaf book with numbered pages, it is advisable to index the accounts. The index below is applicable to the ledger on pages 58-61. The page numbers are those given in connection with the title of each account as explained above.

INDEX

A-D		M-N	
Brown Bros.....	12	Merchandise Inventory.....	10
Burns, W. O.....	4	O-Q	
Cash.....	1	People's Hotel.....	3
Cowan, Robert E.....	8	Purchases.....	22
Dawson Bros. & Co.....	16	R-U	
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E-H		Salary Expense.....	24
General Expense.....	25	Sales.....	21
Gordon, W. A., Capital.....	18	Taylor, J. C.....	7
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Jordan, A. Y.....	2	Wills, James O.....	5
King & King.....	13		
Lake View Creamery.....	14		

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19

Sept 30	643.00	C 2	1 3 4 7 2 5	Sept 30	C 3	7 0 4 2 5
Oct 31	466.1	C 4	1 1 2 5 4 9	Oct 31	C 5	1 2 2 5 1 8 8
			2 4 7 2 7 4			2 4 7 2 7 4
Nov. 1	Balance	✓	4 1 6 6 1			

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19

Sept 5	10 days	\$ 1	1 0 2 5	Sept 5	C 2	1 0 - ✓
11	60 days	\$ 3	5 6 2 5	11	C 2	5 6 2 5
Oct 5	30 days	\$ 1	3 5 5 1	Oct 24	Returned	3 5 5 1
10	27 25	\$ 15 6	1 5 6 2 5 5	30	C 4	5 6 2 5

1036

19

Sept 8	Weekly	\$ 2	5 7 3 5	Sept 8	C 2	5 7 3 5
15		\$ 1	5 7 3 5	15	Returned	5 7 3 5
22		\$ 1	5 7 3 5	22	C 2	5 7 3 5
29		\$ 1	5 7 3 5	29	C 2	5 7 3 5
Oct 6	5 days	\$ 2	1 0 2 5	Oct 6	C 2	1 0 2 5
13		\$ 1	1 0 2 5	13	C 2	1 0 2 5
20	5 days	\$ 2	1 0 2 5	20	C 2	1 0 2 5
27		\$ 1	1 0 2 5	27	C 2	1 0 2 5

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19

Sept 13	10 days	\$ 1	1 0 2 5	Sept 13	C 2	1 0 2 5
Oct 15	10 days	\$ 7	1 0 2 5	Oct 15	C 2	1 0 2 5
27		\$ 23	1 0 2 5	27	C 4	1 0 2 5
27	Postage 33.25	\$ 1	1 0 2 5			

Illustration 28, Ledger, Pages 1-4

PAGE 5

James C. Helie

				Grand St. City			
Sept 1	20 days	\$ 6	44 30	Oct 7	C 2	50	-
	30 days	\$ 11	37 56				
		\$ 17	51 40				
	25 Monday 20 71	\$ 22	38 65				
			177 91				

PAGE 6

James C. Helie

				Grand St. City			
Sept 22	1 days	\$ 7	26 05	Oct 2	C 2	50	-
	20 days	\$ 7	44 25				
	30 days	\$ 11	70 30	25	C 4	20 30	
			130 75				

PAGE 7

J. C. Taylor

				3752 Crescent Ave, City			
Oct 4	30 days	\$ 12	132 55	Oct 31	C 4	150	-
	30 days	\$ 8	56 40				
22	124 37	\$ 20	55 40				
			274 39				

PAGE 8

Robert E. Cowan

				3175 Burnett Ave, City			
Oct 29	10 days	\$ 25	61 53				

PAGE 10

Merchandise Inventory

Sept 1	\$ 1	500	-				
--------	------	-----	---	--	--	--	--

PAGE 12

Brown Bros.

				220 Park St. City			
Sept 6	C 3	79 30		Sept 29	Net cash P 1	79 30	
8	C 3	194	-	5	9/4-Net cash P 1	194	-
24	Returned	\$ 1 a	12 60	10	9/4-30 days P 1	a 230	-
30	C 3	b 150	-	15	9/13 P 1	b 248	-
		152 50		23	9/12-10 days P 1	c 199 10	
Oct 3	C 3	c 199 10					
9	C 3	a 200	-	Oct 16	9/15-30 days P 1	d 216 50	
18	C 5	b 98	-				
20	Error	\$ 1 d	6 10				
			70				

King & King

PAGE 13

16 York St, City

¹⁹ Sept 13	C 3	100 -	¹⁹ Sept 3	9/2-10 days	P 1	132 95
20	C 3	136 75				
Oct. 9	C 3	174 75		29 9/2-10 days	P 1	174 75
			Oct. 20	10/2-30 days	P 1	127 65
			28	10/27-30 days	P 1	141 32

Lake View Creamery

PAGE 14

Dayton

¹⁹ Oct 7	C 3	30 -	¹⁹ Sept 17	9/5-20 days	P 1	30 -
			Oct 15	10/13-20 days	P 1	48 -

Dick, Mc Millan & Co.

PAGE 15

Springfield

¹⁹ Oct. 16	C 5	381 78	¹⁹ Oct 1	9/30-15 days	P 1	381 78
			24	10/23-15 days	P 1	117 90

Dawson Bros. & Co.

PAGE 16

Lebanon

¹⁹ Oct 27	10/25-30 days	P 1	307 55
----------------------	---------------	-----	--------

W. A. Gordon, Capital

PAGE 18

¹⁹ Sept 1	C 2	1000 -
1	D 1	500 -

W. A. Gordon, Drawing

PAGE 19

¹⁹ Oct. 1	C 3	100 -
----------------------	-----	-------

PAGE 21

Sales

¹⁹ Sept. 19	Returned	D 1	910	¹⁹ Sept. 6	C 2	32 - ✓
Oct. 6	"	C 3	250	13	C 2	40 - ✓
24	"	D 1	375	20	C 2	65 - ✓
				27	C 2	48 50
				30	^{725.51} D 1	552 61
				Oct. 4	C 2	87 65
				11	C 2	109 80
				18	C 4	129 50
				27	C 4	136 45
				31	C 4	87 19
				31	2852.65 D 2	107980

PAGE 22

Purchases

¹⁹ Sept. 30	1279.50 P 1	1292 10	¹⁹ Sept. 24	Returned	D 1	1260
Oct. 2	Freight and Drayage	3 25	Oct. 20	Error	D 1	100
31	2612.50 P 1	1340 75				

PAGE 23

Rent Expense

¹⁹ Sept. 4	C 3	65 - ✓
Oct. 1	C 3	65 -

PAGE 24

Salary Expense

¹⁹ Sept. 30	C 3	75 - ✓
Oct. 31	C 5	75 -

PAGE 25

General Expense

¹⁹ Sept. 30	C 3	4 - ✓	¹⁹ Oct. 21	C 4	50
Oct. 13	C 3	18 50	27	D 1	60
17	26.40 C 5	25 5			

Trial Balances. Illustration 29 below shows the Trial Balances for September and October. This form is sometimes referred to as a *continuous Trial Balance*. Only two Trial Balances are illustrated, but with additional columns any desired number of Trial Balances can be included.

When a Trial Balance of this type is used, it is customary to prepare a chart of all the accounts required and to arrange them in the ledger in accordance with the chart. When the accounts are copied on the Trial Balance, space is left for those accounts on the chart which have not yet been opened so that the accounts on the Trial Balance will be always in the same order as in the ledger.

W. A. Gordon Trial Balances

L. F.	NAME OF ACCOUNT	SEPTEMBER 30 19				OCTOBER 31 19			
1	Cash	643	-			416	61		
2	W. A. Gordon	56	25			77	25		
3	Peoples Hotel	153	45			464	80		
4	W. O. Burns	19	40			33	85		
5	James C. Hille	44	30			12	91		
6	James C. Hille	107	86						
7	J. B. Taylor					124	37		
8	Robert E. Cowan					61	93		
10	Merchandise Inventory	500	-			500	-		
12	Brown Bros.			514	50			223	00
13	King & King			174	75			260	62
14	Lake View Creamery			50	-			48	-
15	Dick, McMillan & Co.							117	80
16	Dawson Bros. & Co.							307	55
18	W. A. Gordon, Capital	1	1	1500	-			1500	-
19	W. A. Gordon, Drawing						100	-	
21	Sales			728	51			2352	65
22	Purchased	1279	50			261	250		
23	Rent Expense	65	-			130	-		
24	Salary Expense	75	-			150	-		
25	General Expense	40	-			2640			
		2944	776	2944	776	4819	02	4819	02

Illustration 29, Continuous Trial Balance

REPORT

Complete Report No. 16 in the work book and submit it to the instructor for approval; he will direct you as to whether you are to continue with the text until Report No. 17 is required on page 65, or complete the Part I Practice Set before beginning with page 63 of the text.

CHAPTER VI

WORK AT THE CLOSE OF THE FISCAL PERIOD

The discussion and illustrations in the preceding chapters relate to the method of recording transactions so as to provide the daily information needed by the owner regarding the amount of his assets, liabilities, the increases in proprietorship and the decreases in proprietorship. The discussion in this chapter relates to the work of the accountant at the time it is desired to ascertain the profit. The discussion and illustrations are based on the model set in the preceding chapter.

Fiscal Period. The proprietor of a business will want to know from time to time the results of operating the business because he has invested cash or other assets for the purpose of making a profit, that is, increasing the amount of his proprietorship in the assets. Since the Federal Government requires an annual report of income for income tax purposes, the proprietor of a business must ascertain profit or loss at least once each year.

If the nature of the business is such that the net profit should be ascertained more often, it may be determined monthly, bi-monthly, quarterly or semi-annually. The term *fiscal period* is used in accounting to describe the period for which the profit is ascertained. W. A. Gordon, whose books of account are shown in Chapter V, wishes to ascertain his profit October 31. Since the business has been operated for two months, the length of the fiscal period is two months and may be referred to as a bi-monthly fiscal period.

Accounting at the Close of a Fiscal Period. As explained in the first chapter, the purpose of a business is to provide profit for the owner, that is, an increase in his proprietorship. At the close of each fiscal period, the proprietorship and profit is ascertained by the accountant and reported to the owner on two separate reports.

The information used as a basis for the preparation of these reports may be obtained from the ledger when it is in balance and all changes in assets, liabilities and proprietorship have been recorded. At the close of the fiscal period, the accountant is required to record the changes in assets, liabilities and proprietorship which have not been recorded during the period.

The increases (income) and decreases (expense) in proprietorship are usually recorded in accounts separate from the one with the proprietor, hence the present proprietorship reported to him will be more or less than that shown by his account. It is customary at the close of the fiscal period to summarize the increases and decreases in a summary account and to transfer the balance of this account to the owner's Capital account, so that the balance of his account will be the same as the present proprietorship reported to him.

The work of the accountant at the close of the fiscal period may be briefly described as follows:

- (1) Ascertain the value of the merchandise on hand.
- (2) Ascertain the present proprietorship and net profit and proof of their correctness.
- (3) Prepare the two reports, one showing assets, liabilities and present proprietorship and the other income, expense and net profit.
- (4) Record in the journal the entries necessary to have the account balances in the ledger show the same facts as reported to the proprietor, post these entries and rule the accounts that balance.
- (5) Balance the Cash and Capital accounts.
- (6) Prove that the ledger is in balance through a Trial Balance.

The work required of the accountant for W. A. Gordon at the close of the fiscal period, October 31, is described and illustrated in the paragraphs which follow. The ledger on pages 58-61 and the October 31 Trial Balance on page 62 are used as a basis for the preparation of the reports.

Merchandise Inventory. A list of the merchandise with the value extended at cost is referred to in accounting as the *merchandise inventory*. Present market price, when less than cost, may be used to ascertain the value of the merchandise in stock. Market price, however, is not used when it is more than cost. Counting the merchandise to ascertain its value is referred to as "taking stock." The value of the merchandise inventory may be ascertained at any time but must be known at the close of a fiscal period.

Taking Stock. The clerks usually count the units of merchandise to secure the number in stock and the accountant ascertains their cost value from the invoices. The illustration at the right shows the completed inventory prepared for W. A. Gordon at the close of the fiscal period, October 31.

You will observe from the illustration that the total value of the merchandise is \$1,477.15. You will also observe that this amount is used as the asset value of the merchandise in stock when reporting the assets, liabilities and proprietorship to W. A. Gordon as explained and illustrated in a subsequent paragraph. You must keep in mind the fact that the cost price of merchandise bought for sale is usually regarded as the asset value. Thus, W. A. Gordon paid \$1.10 for each dozen cans of tomatoes, hence he regards the asset value of each dozen cans as \$1.10.

W. A. GORDON
MERCHANDISE INVENTORY, OCTOBER 31, 19..

1216	lbs. Granulated Sugar (per 100 lbs.)	4.50	\$ 54.72
1183	lbs. Brown Sugar . . . (per 100 lbs.)	4.10	49.50
256	lbs. Roasted Coffee	.22	56.32
1602	lbs. Bacon	.15	270.30
8	Hams, 183 lbs.	.17	31.11
5	cans Lard, 261 lbs.	.16	41.76
24	doz. cans Tomatoes	1.10	26.40
20	doz. cans Pineapple	2.00	40.00
18	doz. cans Peaches	1.95	35.10
20	doz. cans Corn	1.50	30.00
268	lbs. Creamery Butter	.33	88.44
60	bbls. Blue Ribbon Flour	5.10	306.00
34	bbls. White Rose Flour	5.25	178.50
25	bbls. Fancy Flour	6.00	150.00
25	bu. Beans	1.60	40.00
20	boxes Werk's Soap	4.00	80.00

Value of merchandise on hand \$1477.15

Proof of Inventory. The amount of cash on hand, ascertained by count, may be proved to be correct because it should agree with the balance of the Cash account in the ledger. The amount of the merchandise on hand, ascertained by count, cannot be proved in the same manner because there is no account in the ledger, the balance of which shows the amount of merchandise which should be on hand.

For the reason stated in the preceding paragraph, it is necessary to use care in the count, in the cost price and in the calculations necessary to ascertain the value of each kind of merchandise and the total value of the merchandise. The count, the cost price and the calculations are usually verified by two or three persons, and calculating machines used when available, to be sure that the amount is correct. It is quite evident that an over- or under-statement of the value of the merchandise in stock would cause the assets and the profit to be over- or under-stated.

Cost of Sales. The cost of the merchandise sold during a fiscal period is referred to as the cost of sales. It is necessary to ascertain the cost of sales at the close of each fiscal period. This information is obtained by subtracting the asset value of the merchandise unsold (merchandise inventory at the close of the period) from the cost of merchandise available for sale (beginning inventory as recorded in the Merchandise Inventory account and total purchases as shown by the balance of the Purchases account).

REPORT

Complete Report No. 17 in the work book and present for approval. Continue with the text discussion until Report No. 18 is required on page 72.

Work Sheet. At the close of each fiscal period it is customary for the accountant to submit to the owner two written reports, one known as the Balance Sheet showing assets, liabilities and proprietorship, and the other as the Profit and Loss Statement showing income, expenses and net profit. The accountant can prepare these reports from the Trial Balance and the merchandise inventory and other inventories. If this plan is followed, however, it will be necessary to make the necessary calculations for adjustments because of the inventory or inventories and to complete both reports to prove the correctness of each.

Because of the possibility of errors which may result in making the adjustments and the necessity of completing both reports before knowing that either is correct, it is customary to make the adjustments on a ruled form known as a *Work Sheet* or *Working Sheet* and through the completion of this Work Sheet ascertain present proprietorship, net profit, and proof of the correctness of both before preparing the Balance Sheet and Profit and Loss Statement.

The illustration below is the form of Work Sheet used by the accountant for ascertaining present proprietorship, net profit and proof of their correctness before preparing the Balance Sheet and Profit and Loss Statement submitted to W. A. Gordon October 31. This Work Sheet is an extended form of the Trial Balance since all the information contained in the eight columns is obtained from the October 31 Trial Balance and the merchandise inventory. The purpose of each of the eight columns is indicated by the title of each column.

W. A. Gordon
Work Sheet, October 31, 19-

NAME OF ACCOUNT	TRIAL BALANCE		ADJUSTMENTS		P & L STATEMENT		BALANCE SHEET	
	DR.	CR.	DR.	CR.	COSTS & EX.	INCOME	ASSETS	LIAB & PR.
Cash	41661						41661	
W. A. Gordon	7725						7725	
Peoples Hotel	46430						46430	
W. O. Burns	3385						3385	
James O. Mills	12191						12191	
J. C. Tantor	12437						12437	
Robert & E. Cowan	6183						6183	
Merchandise Inventory	500 -		147715	500 -			147715	
Brown Bros.		22390						22390
King & King		26902						26902
Lake View Creamery		48 -						48 -
Dick, McMillan & Co.		11790						11790
Dawson Bros. & Co.		30755						30755
W. A. Gordon Capital		1500 -		100 -				1400 -
W. A. Gordon's Drawing	100 -			100 -				
Salaries		235265				235265		
Purchase Discounts	201250		500 -	147715	163535			
Rent Expense	130 -				130 -			
Salary Expense	150 -				150 -			
General Expense	2640				2640			
	481202	481902	200715	207715	194175	235265	277727	236637
Net Profit					41090			41090
					235265	235265	277727	277727

Illustration 30, Work Sheet

The Method of Preparing the Work Sheet in the above illustration is briefly described in the paragraphs which follow.

- (1) The October 31 Trial Balance on page 62 was copied in the Name of Account and the first two amount columns.
- (2) The merchandise inventory October 31, \$1,477.15, is entered in the debit Adjustments column on a line with Merchandise Inventory and in the

credit Adjustments column on a line with Purchases because it is desired to record the merchandise inventory as an asset and subtract the amount from the debit balance of the Purchases account. This adjustment is made because the asset value of the merchandise sold was not recorded in each sale, hence there is no account on the ledger which shows the asset value of merchandise on hand. See note on page 14.

(3) The amount of the merchandise inventory September 1, \$500.00, as shown on the Trial Balance is entered in the credit Adjustments column on a line with Merchandise Inventory and in the debit Adjustments column on a line with Purchases because it is desired to transfer the September 1 inventory to the Purchases account.

(4) \$100.00 is entered in the debit Adjustments column on a line with W. A. Gordon, Capital and in the credit Adjustments column on a line with W. A. Gordon, Drawing because it is desired to transfer the balance of the Drawing account to the Capital account.

(5) The balance of each of the first seven accounts is an asset, hence each amount is entered in the Assets column because it is desired to ascertain the total assets by adding the amounts in the one column.

(6) The amount in the debit Adjustments column on a line with Merchandise Inventory is added to the debit balance on the Trial Balance; the amount in the credit Adjustments column is subtracted from the sum of the two, and the difference entered in the Assets column; this difference is the merchandise inventory, October 31.

(7) The balance of each of the five accounts with creditors is a liability and is entered in the Liabilities column because it is desired to ascertain the total liabilities by adding the amounts in the one column.

(8) The amount in the debit Adjustments column on a line with W. A. Gordon, Capital is subtracted from the credit balance on the Trial Balance and the difference, \$1,400.00, entered in the Liabilities and Proprietorship column. You will observe that liabilities and proprietorship are entered in the same column which indicates that they are to be added together. This is correct because the sum of the assets always equals the sum of the liabilities and the proprietorship.

(9) The \$100.00 in the credit Adjustments column on a line with W. A. Gordon, Drawing indicates that the amount is to be subtracted from the debit balance. Since the two amounts are equal there is no amount to extend.

(10) The balance of the Sales account is the total sales which is regarded as an income, hence it is entered in the Income column so that the total income may be ascertained by adding the column.

(11) The amount in the debit Adjustments column on a line with Purchases is added to the debit balance on the Trial Balance; the amount in the credit Adjustments column is subtracted from the sum of the two and the difference, \$1,635.35, entered in the Costs column. The difference between the value of merchandise available for sale (beginning inventory plus purchases) and the

asset value of the merchandise on hand is the cost of the merchandise sold, as explained on page 65.

(12) The balance of each of the three expense accounts is an expense, hence entered in the Expense column. You will observe that costs and expenses are entered in the same column which indicates that they are to be added. This is correct since the sum of the cost of the merchandise sold and the expenses is to be deducted from total income to ascertain net profit.

(13) Each of the six columns at the right of the Trial Balance is footed and the total of each entered on the same blue line on which the totals of the Trial Balance are entered. The liabilities in the Liabilities and Proprietorship Column are added and the totals indicated with small pencil figures as in the illustration.

The total of the debit Trial Balance column equals the total of the credit Trial Balance column which proves that the ledger is in balance. The total of the debit Adjustments column equals the total of the credit Adjustments column which proves that the equality of debits and credits has been maintained in making the adjustments.

The total of the Costs and Expense column does not equal the total of the Income column; neither does the total of the Assets column equal the total of the Liabilities and Proprietorship column. The reason for this is because the income exceeds the costs and expenses the amount of the net profit and the assets exceed the sum of the liabilities and proprietorship the same amount.

(14) The net profit should be the difference between the total income and the total expenses, also the difference between the proprietorship at the beginning and the present proprietorship. Total income, \$2,352.65, — total cost and expense, \$1,941.75, = \$410.90, net profit.

Total assets, \$2,777.27, — total liabilities, \$966.37 = present proprietorship, \$1,810.90; present proprietorship, \$1,810.90, — net investment, \$1,400.00 = \$410.90, net profit.

The net profit, \$410.90, is entered in the Costs and Expense column to make this total equal that of the Income column, and in the Liabilities and Proprietorship column to make this total equal that of the Assets column. The Balance Sheet and Profit and Loss Statement columns are then ruled with single and the double lines and the footings entered between the lines.

You must keep in mind the fact that the purpose of the Work Sheet is to ascertain present proprietorship, net profit and proof of their correctness. When the difference between the total of the Income column and the total of the Costs and Expense column is the same as the difference between the total of the Assets column and the total of the Liabilities and Proprietorship column, the present proprietorship and net profit may be regarded as correct. Even with this proof there is a possibility of an error because an asset extended as an expense and vice versa or a liability extended as an income and vice versa would not affect the proof but it would overstate or understate the net profit and present proprietorship. The arrangement of the accounts in the ledger

as shown by the listing on the Trial Balance lessens the possibility of errors of this kind because the grouping indicates assets, liabilities, proprietorship, income and expense.

Balance Sheet. A formal written report of assets, liabilities and proprietorship is referred to as a *Balance Sheet*, *Financial Statement*, or *Statement of Assets, Liabilities and Proprietorship*. The Balance Sheet contains the following information:

(1) The title which is the name of the owner, the name of the report and the date of the report which is the date of the close of the fiscal period.

(2) A description and amount of each asset as shown by account balances on the ledger, the merchandise inventory and the total assets.

W. A. Gordon
Balance Sheet, October 31, 19

<i>Assets</i>			
<i>Cash</i>		<i>416.61</i>	
<i>Accounts Receivable:</i>			
<i>A. Y. Jordan</i>	<i>77.25</i>		
<i>Peoples Hotel</i>	<i>464.30</i>		
<i>W. O. Burns</i>	<i>33.85</i>		
<i>James O. Mills</i>	<i>121.91</i>		
<i>J. C. Taylor</i>	<i>124.37</i>		
<i>Robert E. Cowan</i>	<i>61.83</i>	<i>883.51</i>	
<i>Merchandise Inventory</i>		<i>1477.15</i>	
<i>Total Assets</i>			<i>2777.27</i>
<i>Liabilities</i>			
<i>Accounts Payable:</i>			
<i>Brown Bros.</i>		<i>223.90</i>	
<i>King & King</i>		<i>269.02</i>	
<i>Lake View Creamery</i>		<i>48 -</i>	
<i>Dick, Mc Millan & Co.</i>		<i>117.90</i>	
<i>Dawson Bros. & Co.</i>		<i>307.55</i>	
<i>Total Liabilities</i>			<i>966.37</i>
<i>Proprietorship</i>			
<i>W. A. Gordon's Capital, Sept. 1, 19-</i>		<i>1500 -</i>	
<i>Add Net Profit</i>	<i>410.90</i>		
<i>Less Withdrawals (Drawing account)</i>	<i>100.00</i>		
<i>Net Increase in Proprietorship</i>		<i>310.90</i>	
<i>Total Proprietorship</i>			<i>1810.90</i>

Illustration 31, Balance Sheet in Report Form

(3) A description and the amount of each liability as shown by account balances on the ledger, and the total liabilities.

(4) The proprietorship which is the difference between the total assets and total liabilities.

The Balance Sheet may be prepared at any time the value of the merchandise inventory is known but is usually prepared only at the close of the fiscal period. It is usually prepared in report form as in Illustration No. 31, though it may be prepared in account form as in Illustration No. 32, below. The Balance Sheet columns of the Work Sheet or the asset and liability accounts and merchandise inventory provide a basis for the information shown on the Balance Sheet. The information shown on the Balance Sheet is applicable only on the date of the Balance Sheet. In other words, it shows the financial condition of the business on a definite date usually given as the date on which the fiscal period closes or on which the next fiscal period begins. Thus, the date of the Balance Sheet illustrated may be October 31 or November 1.

Illustration 31 on page 69 is a Balance Sheet in report form prepared from the Balance Sheet columns of the Work Sheet, Illustration 30. The totals stated in equation form are:

ASSETS \$2777.27 – LIABILITIES \$966.37 = W. A. GORDON, PROP. \$1810.90

Illustration 32 below shows a Balance Sheet containing the same facts as Illustration 31 prepared in account form. The totals stated in equation form are:

ASSETS \$2777.27 = LIABILITIES \$966.37 + W. A. GORDON, PROP. \$1810.90

W. A. GORDON			
BALANCE SHEET, OCTOBER 31, 19			
Assets		Liabilities and Proprietorship	
Cash	416 61	Liabilities:	
Accounts Receivable:		Accounts Payable:	
A. Y. Jordan	77 25	Brown Bros.	223 90
People's Hotel	464 30	King & King.	269 02
W. O. Burns.	33 85	Lake View Creamery	48 00
James O. Wills	121 91	Dick, McMillan & Co.	117 90
J. C. Taylor	124 37	Dawson Bros. & Co.	307 55
Robert E. Cowan.	61 83	Total Liabilities.	966 37
Merchandise Inventory.	1477 18	Proprietorship:	
		W. A. Gordon's Investment, Sept. 1	1500 00
		Add Net Profit	410 90
		Less Withdrawals	100 00
		Net Increase in Proprietorship	310 90
		Total Proprietorship, October 31	1810 90
Total Assets	2777 27	Total Liabilities and Proprietorship	2777 27

Illustration 32, Balance Sheet in Account Form

You will observe that all the figures for the Balance Sheet are shown in the Balance Sheet columns except the proprietorship September 1 and the withdrawals; this information is obtained from the credit balance of the Capital account and the debit balance of the Drawing account on the Trial Balance.

If desired, the Balance Sheet may show only present proprietorship and the information regarding investments, withdrawals and net profit be shown in a separate report known as an *analysis of proprietorship*.

Profit and Loss Statement. A formal written report of income, expense and net profit is referred to as a *Profit and Loss Statement*, *Income and Expense Statement*, *Statement of Income and Expense* or *Loss and Gain Statement*. The Profit and Loss Statement contains the following information:

- (1) The title which is the name of the owner, the name of the report, and the period to which it is applicable.
- (2) The amount of income from sales, cost of sales, and gross profit on sales.
- (3) The amount of expenses.
- (4) The amount of net profit.

H. A. Gordon
Profit and Loss Statement for September and October, 19-

<i>Merchandise Sales</i>			
<i>Net Sales</i>			<i>235265</i>
<i>Cost of Merchandise Sold</i>			
<i>Merchandise Inventory September 1, 19-</i>	<i>500 -</i>		
<i>Purchases</i>	<i>261250</i>		
<i>Total Cost of Merchandise for Sale</i>	<i>311250</i>		
<i>Less Inventory, October 31, 19-</i>	<i>147715</i>		
<i>Cost of Merchandise Sold</i>			<i>163535</i>
<i>Gross Profit on Sales</i>			<i>71730</i>
<i>Operating Expenses:</i>			
<i>Rent Expense</i>	<i>130 -</i>		
<i>Salary Expense</i>	<i>150 -</i>		
<i>General Expense</i>	<i>2640</i>		
<i>Total Operating Expense</i>			<i>30640</i>
<i>Net Profit</i>			<i>41090</i>

Illustration 33, Profit and Loss Statement

The Profit and Loss Statement may be prepared at any time the cost of sales is known but is usually prepared only at the close of the fiscal period. It is usually prepared only in one form as illustrated above. The Profit and Loss Statement columns of the Work Sheet or the income and expense account balances and the merchandise inventory provide a basis for the information shown on the Profit and Loss Statement.

The Profit and Loss Statement shows the net profit for the fiscal period, hence the title should include the beginning and closing dates of the period.

In other words, the Profit and Loss Statement shows the net profit resulting from operating the business during a definite period of time.

The information in the Profit and Loss Statement, Illustration 33, was prepared from the Costs and Expense and Income columns of the Work Sheet, Illustration 30. The information regarding cost of sales is obtained from the balances of the Merchandise Inventory and Purchases accounts on the Trial Balance because it is not possible to show addition and subtraction in the Costs and Expense column of the Work Sheet.

When W. A. Gordon receives the Balance Sheet and Profit and Loss Statement discussed and illustrated here, he will have available the same information which he could obtain from the ledger and merchandise inventory if he desired to do so. It has been reported to him by the accountant because one of the duties of the accountant is to record each transaction completed so as to provide the daily information needed and that which will be needed at the close of the fiscal period.

REPORT

Complete Report No. 18 in the work book and present to the instructor for approval. Continue with the text discussion until Report No. 19 is required on page 80.

Closing the Ledger. The process of recording the merchandise inventory in the Merchandise Inventory account and the net profit in the proprietor's Capital account is referred to in accounting as *closing the ledger*. The ledger is usually closed at the end of each fiscal period. The purpose of closing is to have at the beginning of each fiscal period account balances in the ledger which will show the same facts as the assets owned by the proprietor of the business, the liabilities he owes and his proprietorship.

The account balances in the ledger at the close of the fiscal period do not show the facts desired at the beginning of the next fiscal period. The process of closing the ledger in order that it will show the desired facts requires the following entries in the general journal and ledger:

(1) An entry to transfer the balance of the Merchandise Inventory account to the Purchases account.

(2) An entry to record the merchandise inventory at the close of the fiscal period as a debit to the Merchandise Inventory account and a credit to the Purchases account.

(3) An entry to transfer the balance of the Drawing account to the Capital account.

The figures for these three entries are obtained from the Adjustments columns of the Work Sheet, hence they are sometimes referred to as *adjusting entries*.

(4) An entry to transfer the balance of the Sales account to the Profit and Loss Summary account.

(5) An entry to transfer the balance of the Purchases account (cost of the merchandise sold) to the Profit and Loss Summary account.

(6) An entry to transfer the balance of each expense account to the Profit and Loss Summary account.

(7) An entry to transfer the balance of the Profit and Loss Summary account to the Capital account.

The figures for the last four entries are obtained from the Profit and Loss Statement columns of the Work Sheet and are referred to as *closing entries*.

Profit and Loss Summary Account. This account is not necessary in the ledger closing process since the balance of each expense or income account may be closed direct into the Capital account. It is customary, however, with accountants to use a summary account when it is desired to transfer the balances of two or more accounts to another account. The purpose of the Profit and Loss Summary account is to summarize the income, costs and expenses as shown by the account balances at the close of the fiscal period. To accomplish this purpose the Profit and Loss Summary account is *debited* for the balance of the Purchases account and each expense account and is *credited* for the balance of the Sales account or any other income account. The *credit* balance of the Profit and Loss Summary account shows the net profit to be transferred to the Capital account.

Each amount recorded on the debit side of the Profit and Loss Summary account as a result of closing the cost and expense accounts will agree with each amount in the Costs and Expense column of the Work Sheet. Each amount on the credit side of the Profit and Loss Summary account will agree with each amount in the Income column of the Work Sheet. The balance of the Profit and Loss Summary account will agree with the net profit recorded in the Costs and Expense column of the Work Sheet.

The credit balance of the Profit and Loss Summary account is transferred to the Capital account through posting a journal entry in which the Profit and Loss Summary account is debited for the net profit and the Capital account credited for the same amount. Should the business be operated at a loss, the Profit and Loss Summary account will show a debit balance, hence it will be necessary to debit the Capital account and credit the Profit and Loss Summary account in order to transfer this loss to the Capital account.

Closing the Ledger for W. A. Gordon. The seven journal entries on page 76 are those required to close the ledger of W. A. Gordon on pages 58-61. These seven entries are those described in connection with closing the ledger in the preceding paragraphs.

The account titles and figures for the first three entries are obtained from the Adjustments columns of the Work Sheet and the last four entries from

the Profit and Loss Statement columns of the Work Sheet, Illustration 30, page 66. The ledger on pages 77 and 78 contains the accounts affected by the closing entries after these entries have been posted and the accounts ruled. Compare each entry with the Work Sheet, with the ledger in Chapter V and with the ledger on pages 77 and 78. The purpose of these entries is briefly described as follows:

First Entry. The purpose of this entry is to transfer the balance of the Merchandise Inventory account on the Trial Balance to the Purchases account because it is desired to have the Purchases account contain a record of all the merchandise made available for sale. The amount, \$500.00, is entered in the debit Adjustments column on a line with Purchases and in the credit Adjustments column on a line with Merchandise Inventory, hence in the journal entry Purchases is debited and Merchandise Inventory credited. When this entry is posted, the Merchandise Inventory account will be in balance, hence is ruled, and the \$500.00 will appear on the debit side of the Purchases account. See the Merchandise Inventory account on page 77 (above the ruled lines) and the last entry on the debit side of the Purchases account on page 78.

Second Entry. The purpose of this entry is to record the merchandise inventory October 31. It is desired to have the value of this asset recorded as a debit to the Merchandise Inventory account and as a credit to the Purchases account in order that the balance of the Purchases account may show the cost of the merchandise sold. The amount, \$1,477.15, is entered in the debit Adjustments column on a line with Merchandise Inventory and in the credit Adjustments column on a line with Purchases, hence in the journal entry Merchandise Inventory is debited and Purchases credited. When this entry is posted, the Merchandise Inventory account will show the asset value of the merchandise in stock, October 31, on the debit side, and the balance of the Purchases account will show the cost of the merchandise sold. See Merchandise Inventory account on page 77 (below the ruled line) and the third entry on the credit side of the Purchases account on page 78.

Before these two entries have been recorded and posted, the merchandise on hand September 1 is shown by the debit balance of the Merchandise Inventory account, the total cost of merchandise purchased during September and October is shown by the debit balance of the Purchases account, and the value of the merchandise inventory, October 31, is not recorded. After these two entries are posted, the balance of the Merchandise Inventory account shows the asset value of the merchandise in stock, October 31, and the balance of the Purchases account shows the cost of the merchandise sold. It is quite evident that if the debit side of the Purchases account shows the total cost and all the merchandise has not been sold that the difference between the total amount of merchandise bought and the total amount that has not been sold is the cost of the merchandise sold.

Third Entry. The purpose of this entry is to transfer the Drawing account to the Capital account because it is customary to transfer the debit balance of the Drawing account to the Capital account at the close of the fiscal period. The \$100.00 is entered in the debit Adjustments column on a line with W. A. Gordon, Capital, and in the credit Adjustments column on a line with W. A. Gordon, Drawing, hence in the journal entry, the Capital

account is debited and the Drawing account credited. When this entry is posted, the Drawing account is ruled as in the illustration on page 77 and the \$100.00 appears on the debit side of the Capital account as in the illustration on page 77.

This concludes the three entries required to record the amounts in the Adjustments columns on the Work Sheet. The four entries which follow are those required to record the amounts in the Profit and Loss Statement columns in order that the net profit may be credited to the Capital account.

Fourth Entry. The purpose of this entry is to transfer the balance of the Sales account to the Profit and Loss Summary account. Since the Sales account shows a credit balance of \$2,352.65, it will be necessary to debit the Sales account and credit the Profit and Loss Summary account for this amount. When this entry is posted, the Sales account will be in balance and is footed and ruled as in the illustration on page 77. The amount of the sales will appear on the credit side of the Profit and Loss Summary account as in the illustration on page 78.

Fifth Entry. The purpose of this entry is to transfer the balance of the Purchases account to the Profit and Loss Summary account. The balance of the Purchases account now shows the cost of the sales as explained in connection with the second entry. Since the Purchases account shows a debit balance of \$1,635.35, it is necessary to credit it and debit the Profit and Loss Summary account in order to make the transfer. When this entry is posted, the Purchases account will be in balance and is ruled and footed as in the illustration on page 78. The cost of the merchandise sold, \$1,635.35, will appear on the debit side of the Profit and Loss Summary account as in the illustration on page 78. Since the Profit and Loss Summary account was credited with the sales in the fourth entry, the balance of the account now shows the gross profit on sales reported on the Profit and Loss Statement.

Sixth Entry. The purpose of this entry is to transfer the balance of each of the three expense accounts to the Profit and Loss Summary account. This transfer may be made by three separate entries or by one entry as in the illustration. Since each of the three expense accounts has a debit balance, it is necessary to debit the Profit and Loss Summary account for the sum of the three accounts and credit each account for its balance. When this entry is posted, each of the expense accounts will be in balance and each is ruled and footed as in the illustration on page 78. The amount of each expense is on the debit side of the Profit and Loss Summary account; it is customary when posting to show the balance of each account in the amount column and the account title in the explanation column instead of the one amount in the debit entry.

A journal entry which has more than one debit amount and account title or more than one credit amount and account title is referred to as a *compound journal entry*. It is quite evident that the sum of the amounts debited should equal the sum of the amounts credited in each compound journal entry.

(Continued on page 79)

October 31, 19--

PAGE 1

22	Merchandise	500 -	
10	Merchandise Inventory		500 -
	To transfer the inventory September 1 to the Merchandise account		
	31		
10	Merchandise Inventory	1477.15	
22	Purchases		1477.15
	To record the inventory October 31		
	31		
18	W. A. Gordon, Capital	100 -	
19	W. A. Gordon, Drawings		100 -
	To transfer the balance of the Drawing account to the Capital account		
	31		
21	Sales	2352.65	
26	Profit and Loss Summary		2352.65
	To close the Sales account		
	31		
26	Profit and Loss Summary	1635.35	
22	Purchases		1635.35
	To close the Purchases account		
	31		
26	Profit and Loss Summary	306.40	
23	Rent Expense		130 -
24	Salaries Expense		150 -
25	General Expense		26.40
	To close the operating expense accounts		
	31		
26	Profit and Loss Summary	410.90	
18	W. A. Gordon, Capital		410.90
	To close the Profit and Loss Summary account		

Illustration 34, Closing Entries

PAGE 10

Merchandise Inventory

¹⁹ Sept. 1	J 1	500 -	¹⁹ Oct. 31	J 2	500 -
Oct. 31	J 2	1477 15			

W. A. Gordon, Capital

PAGE 18

¹⁹ Oct. 31	J 2	100 -	¹⁹ Sept. 1	C 2	1000 - ✓
31 Present Capital	✓	1810 90	1	J 1	1500 - ✓
		1910 90	Oct. 31 P.L. Summary	J 2	410 90
					1910 90
			Nov. 1 Present Capital	✓	1810 90

W. A. Gordon, Drawing

PAGE 19

¹⁹ Oct. 1	C 3	100 -	¹⁹ Oct. 31	J 2	100 -
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PAGE 21

Sales

¹⁹ Sept. 19 Returned	J 1	91 5	¹⁹ Sept. 6	C 2	32 - ✓
Oct. 6 "	C 3	250	13	C 2	40 - ✓
24 "	J 1	375	20	C 2	65 - ✓
31 P.L. Summary	J 2	2352 65	27	C 2	48 50
			30	728.51 J 1	552 11
			Oct. 4	C 2	87 65
			11	C 2	109 80
			18	C 4	129 50
			27	C 4	136 45
			31	C 4	87 19
			31	2352.65 J 2	1079 80
		2368 -			2368 -

Illustration 35, Ledger Resulting from Posting Closing Entries

PAGE 22

Purchases

19	Sept 30	1270 50	P 1	1270 50	19	Sept 30	Balance	P 1	1260 00
	Oct 2	Freight, Drayage	P 2	22 50		Oct 31	Balance	P 1	1282 50
	31	2622 50	P 1	2622 50		31	Balance	P 1	1282 50
	31		P 2	500 00		31	Balance	P 2	1282 50
				3135 10					3135 10

PAGE 23

Rent Expense

19	Sept 4	P 3	65 00	19	Oct 31	Balance	P 2	130 00
	Oct 1	P 3	65 00					130 00
			130 00					130 00

PAGE 24

Shipping Expense

19	Sept 30	P 3	50 00	19	Oct 31	Balance	P 2	150 00
	Oct 31	P 5	100 00					150 00
			150 00					150 00

PAGE 25

General Expense

19	Sept 30	P 3	20 00	19	Oct 31	Balance	P 2	50 00
	Oct 13	P 3	18 50		27	P 1	140 00	
	17	2640	P 5		31	Balance	P 2	2640 00
			2750 00					2750 00

PAGE 26

Debit and Credit Summary

19	Oct 31	Purchases	P 1	1282 50	19	Oct 31	Debit	P 2	235265
	31	Rent Expense	P 2	130 00					
	31	Shipping Expense	P 2	150 00					
	31	General Expense	P 2	2750 00					
	31	W. O'Brien, Capital	P 2	41090 00					
				235265					235265

Illustration 35, Ledger Resulting from Posting Closing Entries

Seventh Entry. The purpose of this entry is to transfer the balance of the Profit and Loss Summary account to the Capital account. This entry would not be necessary if the balances of the Purchases, Sales and Expense accounts had been transferred direct to the Capital account. Since the Summary account was used and since the Profit and Loss Summary account shows a credit balance, it is necessary to debit the Profit and Loss Summary account and credit the Capital account. When this entry is posted, the Profit and Loss Summary account is ruled and footed as in the illustration and the net profit appears on the credit side of the Capital account as in the illustration on page 77.

Balancing an Account. When it is desired to rule an account which does not balance and carry the balance down below the ruling or forward it to another page, the process is referred to as *balancing the account*. It is customary at the close of the fiscal period to balance the Cash account and the proprietor's Capital account. The method of balancing these accounts is shown in the illustrations on pages 58 and 77.

Post-closing Trial Balance. The accountant knows that the net profit and proprietorship reported to the owner are correct through the proof effected by the Work Sheet. He knows that the equality of debits and credits has been maintained in the closing entries because the facts and figures are obtained from the Work Sheet. He does not, however, know that the account balances in the ledger are in balance as a result of posting the closing entries until he has proved this in the same manner as other posting is proved,

W. A. Gordon
Post-closing Trial Balance, October 31, 19—

Cash	416 61	
A. Y. Jordan	77 25	
People's Hotel	464 30	
W. C. Burns	33 85	
James O. Mills	121 91	
J. C. Taylor	124 37	
Robert E. Cowan	61 83	
Merchandise Inventory	1477 15	
Brown Bros		223 90
King & King		269 02
Lake View Creamery		48 —
Dick, McMillan & Co		117 90
Dawson Bros. Co		307 55
W. A. Gordon, Capital		1810 90
	2777 27	2777 27

Illustration 36, Post-closing Trial Balance

that is, through a Trial Balance. The Trial Balance prepared from the ledger after the closing entries are posted and the accounts which balance ruled is referred to as a *Post-closing Trial Balance*. This includes all the open accounts in the ledger in which respect it is the same as other Trial Balances.

Illustration 36 on page 79 is a Post-closing Trial Balance prepared from the ledger of W. A. Gordon after the closing entries have been posted and the accounts that are in balance ruled.

The ledger on pages 77 and 78 does not contain all the accounts in the ledger of W. A. Gordon but only those which were affected by the closing. When comparing this Post-closing Trial Balance with the ledger, it will be necessary to take into consideration the accounts in both ledgers, that is, in Chapter V, pages 58-61, and the ledger accounts in this chapter.

Balance of an Account. As explained on page 10, the difference between the two sides of an account, the sum of the two or more amounts on one side, or the one amount on the one side is referred to as the balance of the account. The balance of each account on the Post-closing Trial Balance shows an asset, a liability, or proprietorship. The balance of each asset account should agree with the value of the asset at cost price. The sum of the balances of the asset accounts minus the sum of the balances of the liability accounts should be the same as the balance of the proprietor's Capital account.

SUMMARY

At the close of the fiscal period the accountant prepares two reports (a) the Balance Sheet, and (b) the Profit and Loss Statement. The information in these reports is obtained from the account balances in the ledger and the merchandise inventory. It is necessary to count the merchandise in order to ascertain its value because there is no account in the ledger which shows the value of the merchandise that should be on hand.

The Work Sheet is a ruled form used by the accountant for ascertaining net profit, present proprietorship and proof of their correctness before preparing the Balance Sheet and Statement of Profit and Loss. The Balance Sheet and Profit and Loss Statement may be prepared from the Trial Balance and inventories, if desired.

The accountant closes the ledger because it is desired to have in the ledger account balances which will show (a) the amount of each asset, (b) the amount of each liability, and (c) the proprietorship. The equation " $\text{Assets} = \text{Liabilities} + \text{Proprietorship}$ " is applicable to the assets owned by the business and the debts it owes at the beginning of each fiscal period, hence these same facts should be shown by account balances in the ledger.

REPORTS

Complete Report No. 19 in the work book and present it for approval. Continue with the text discussion beginning with Chapter VII until Report No. 20 is required on page 86.

PART II
COLUMNAR RECORDS

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*The material for these reports is provided in the work book.

CHAPTER VII

AVOIDING, LOCATING AND CORRECTING ERRORS

The purpose of recording transactions is to provide correct information. If there is an error either in the calculations necessary to ascertain the amount to be recorded or in recording the amount, the information provided from the accounting records is incorrect. This applies not only to the amounts recorded but also to the account titles. It is necessary for the accountant to proceed in a systematic manner in order to avoid errors or if errors are made to locate and correct them. The discussion in this chapter relates to (a) safeguards to avoid errors, (b) effective means of locating errors, and (c) method of correcting errors.

Incorrect Records result from one or more of the following:

- (1) Mathematical calculations.
- (2) Recording an incorrect amount.
- (3) The use of incorrect account titles.
- (4) The failure to record a transaction.

When the amount of a purchase invoice is over or under-stated because of an error in the calculations and the error is not corrected before recording, both the Purchases account and the account with the creditor will contain the wrong information; this is also true if the amount of the invoice is correctly stated but is recorded incorrectly. If the account with one charge customer is debited with a sale made to another charge customer, it is quite evident that both accounts will contain incorrect information. If a sale to a charge customer is not recorded, the amount of the sales and the amount to be collected from the charge customer will both be under-stated the amount of this sale.

Avoiding Errors. The only means of avoiding errors in the extensions of a purchase or sale is to verify the calculations; calculating machines are frequently used for this purpose because they are economical and accurate. Each entry in a journal is made from a business paper; the accountant should compare the amount recorded in the journal with the amount of the business paper before it is filed. Sales tickets or invoices prepared for sales to charge customers should be numbered numerically and arranged in the order of the numbers before the entries are written in the sales journal; this avoids the possibility of failure to record a sale. As each amount is posted, the accountant should compare the amount recorded in the ledger with the amount in the journal to be sure that the ledger entry is correct.

Check Marks. A check mark (✓) should be used by the accountant to indicate verification of amounts (a) which are the result of mathematical calculations and (b) which are recorded in the books of original entry or the ledger. The position of each check mark should indicate its meaning. Thus, a check mark at the right of each amount on an invoice indicates verification, and at the right of the name, that the entry has been made in the purchases journal. In other words, the efficient accountant uses the check mark for a definite purpose and the position of the check mark indicates this purpose.

Each check mark should be made large enough to be seen at a glance, but not so large so as to affect the appearance of the books or forms. You may use the check marks in the illustrations in Chapter VI as a guide for size of those you make in your work to indicate verification and entries. If you cannot interpret the meaning of check marks from their position in an illustration and cannot find this interpretation in the printed discussion which accompanies the illustration, ask the instructor for an explanation.

Detecting Errors. A systematic procedure for the verification and recording of amounts and the use of check marks for a specific purpose will permit detection of the errors which usually occur. No matter how careful one may be, errors may occur because "it is human to err." Some errors may never be detected while others may cause a loss of business through being detected by customers. The proprietor is interested in having satisfied customers and creditors as well as accurate results. Complaints by charge customers because of inaccuracies in the accounting department will eventually result in a loss of business.

The purpose of the Trial Balance is to detect errors but it is not a cure of all ills as applied to errors. For this reason, the clerical worker or accountant must be constantly on his guard to avoid errors and to detect them. It is far better to detect an error before the Trial Balance is prepared than after, even though the nature of the error is such that the Trial Balance will detect it. You will find from experience that it is quite a pleasure to have the Trial Balance balance the first time you take it and that it means much extra work on your part when it does not balance.

Correcting Errors in Amounts Before Posting. When an incorrect amount is recorded on a business paper or in a journal, the correction is made by drawing a line through the incorrect amount and writing the correct amount above it. This applies to entries in the purchases journal, sales journal, and cash book. Each entry in the general journal requires at least two amounts, hence it will be necessary to correct both amounts in the general journal if both the debit and credit amounts are recorded incorrectly. The accountant should also be careful to see that the equality of debits and credits is maintained in each entry in the general journal.

When the error recorded in the purchases journal or sales journal is the result of an error in the mathematical calculations necessary to ascertain the amount of the purchase or a sale, the creditor or charge customer should be

notified at once so that he may correct the error in his records. This is true whether the error increases or decreases the amount of the purchase or the sale. Business ethics require that all errors in extensions be corrected and that all parties interested in the correct amount be notified.

Correcting Errors in Amounts After Posting. When the incorrect amount recorded in a journal has been posted, it will be necessary to draw a line through the amount in both the journal and the ledger and write the correct amount above in each case. Some accountants prefer to make an entry in the general journal to correct errors resulting from posting incorrect amounts but the better plan is to make the correction in both places through crossing out the incorrect amount and writing the correct amount above it. The only exception to this plan is when the error is discovered in a subsequent month, in which case an entry is made in the general journal.

When an amount recorded in a journal is posted to the wrong account in the ledger, a line should be drawn through the amount recorded in the ledger and the record in the journal posted as stated. Thus, if a sale to John Smith is, through error, posted to the account with J. A. Smith, a line is drawn through the amount on the debit side of the account with J. A. Smith and the amount posted to the debit side of the account with John Smith.

Incorrect Account Titles. When the wrong account title is stated in a journal and the error is detected before posting, the entry is corrected by drawing a line through the amount or amounts recorded in the journal, placing a check mark in the folio column of the account or accounts and correctly recording the transaction in the next available space in the journal under the original date on which the transaction was recorded. Under no circumstances should a line be drawn through the incorrect account title and the correct account title written above it. Drawing a line through the amount or amounts recorded in the journal and placing a check mark in the folio column indicates that the entry is not to be posted.

When the error resulting from the use of an incorrect account title in a journal entry is not detected until after it has been posted, it will be necessary to make the correction through an entry in the general journal. The entry in the illustration at the right is to correct an error resulting from debiting express to the Purchases account when it should have been debited to the account with the

July 14, 19...

A. B. Allen.....	3 50	
Purchases.....		3 50
To correct error in account debited for express on July 12 purchase.		

creditor. The entry to record the check has been posted, hence the amount appears as a debit to the Purchases account. To cancel the amount recorded in the Purchases account and record it in the account with A. B. Allen, it is necessary to debit A. B. Allen and credit Purchases.

Erasures. Incorrect amounts or incorrect account titles recorded either in a journal or in the ledger should *not be erased*. When an amount is erased, there is no means of determining the reason for the change, hence erasures may lead the proprietor or anyone examining the books to believe that the change was made by the accountant to defraud the proprietor. The change should therefore be made so that the original entry and the correcting entry can both be examined and the reason for the change determined.

Errors in Posting. There is always a possibility of posting an amount from the purchases journal to a creditor other than the one from whom the purchase is made or in posting an amount from the sales journal to a customer other than the one to whom the sale is made. Errors of this kind may be detected by the creditor or customer but will not be detected by the Trial Balance. When an error in posting to the wrong account is detected, it is customary to correct it by drawing a line through the entry in the wrong account and posting the amount correctly to the account as indicated by the account title in the journal.

REPORT

Complete Report No. 20 in the work book and submit it to the instructor for approval. Continue with the text discussion until Report No. 21 is required on page 88.

Errors Detected by the Trial Balance. When the Trial Balance balances, it indicates (a) that the additions of the Trial Balance are correct, (b) that the correct account balances are listed on the Trial Balance as stated in the ledger, and (c) that the sum of the debits equals the sum of the credits. When the Trial Balance does not balance, it indicates an error (a) in the Trial Balance, (b) in the ledger, or (c) in the books of original entry.

An error in the Trial Balance may be in the addition or in listing the account balances. An error in the ledger may be in addition, subtraction or posting. An error in the purchases or sales journal is usually the result of addition and in the general journal, inequality of debits and credits in a compound journal entry. Errors in the cash book are usually detected through the cash proof, hence the cash book is one book of original entry which if posted correctly will not cause the accountant trouble when he is taking the Trial Balance.

Preparing the Trial Balance. Errors in the Trial Balance result more often from carelessness in preparing the Trial Balance than from errors in the journals or the ledger. The accountant who follows a systematic procedure in preparing the Trial Balance will usually find that his Trial Balance is in balance. The suggestions in the paragraphs which follow will be helpful to you in establishing a systematic procedure for preparing the Trial Balance.

(1) Verify the addition of the purchases and sales journal and the posting of the total.

(2) See that all compound entries in the general journal are in balance; you should indicate with pencil figures the total debits or total credits at the time a compound entry is made in the journal.

(3) Be sure that the cash is in balance before the totals of the cash book are posted to the ledger. If the cash balance at the first of the month is already recorded in the Cash account, see that it is not included in the posting of the totals of the cash book.

(4) Foot each account with pencil figures. If subtraction is necessary to ascertain the balance, write the balance in the explanation column on the larger side; if desired, this subtraction may also be shown in the explanation column. As each account balance is listed on the Trial Balance, be sure that the amount is shown on the larger side of the account and that each amount is entered in the proper column on the Trial Balance.

(5) Verify the addition of each column on the Trial Balance. Do not worry about errors until both columns have been added and the addition verified. If the two columns are not equal, follow the procedure suggested in the paragraphs which follow.

Trial Balance Out of Balance. When the Trial Balance does not balance, it is necessary to follow a systematic procedure. Nothing can be gained by "looking over" the ledger with the hope of finding the error by accident. Any systematic method of procedure is satisfactory. The following plan applied in the order stated is suggested:

(1) Prove the addition of the Trial Balance.

(2) Examine the account balances on the Trial Balance and be sure that all debit balances are in the left column and the credit balances in the right column. The usual arrangement of the accounts in the ledger, that is, assets, liabilities, proprietorship, income and expense means that the balance of each account in the first group (assets) should be in the left column, the second group (liabilities) in the right column, the third group (proprietorship) in the right column, the fourth group (income) in the right column, and the fifth group (expense) in the left column.

(3) Verify each account balance in the ledger. This means verify the addition of each side of the account and the subtraction to determine that the balance stated in the explanation column on the larger side is the correct amount. Where an account has been ruled since the preceding Trial Balance, be sure that it is in balance at the point of ruling.

(4) Verify the listing of the account balances on the Trial Balance. Place a small check mark at the right of each balance in the ledger to indicate verification.

(5) Compare the amount of the error and one-half the amount with each amount in the journals, since the failure to post an amount equal to the error or posting an amount equal to one-half the error to the wrong side will result in the error.

(6) If the amount of the error is divisible by nine, it may indicate transposed figures. Thus a difference of 45c may indicate that .50 was posted as .05, .49 as .94, .38 as .83, .27 as .72, or .16 as .61. You will observe that in each case the difference between the two digits which were posted in reverse order is 5, which is the same as the quotient resulting from dividing the amount of the error by 9. When an error is divisible by 9 without a remainder, and the error results from transposed figures, the amount posted incorrectly will be a number composed of two digits whose difference is the same as the quotient resulting from dividing the amount of the error by 9. This statement applies to any two adjacent figures expressed in dollars as well as to two adjacent figures expressed in cents.

(7) Verify the addition of the purchases journal, sales journal and the equality of the debits and credits in the general journal.

(8) Check the posting from all journals; use check marks to indicate each verification. When the posting has been checked, examine the journals and ledger for amounts that may not be checked.

Correcting Errors Detected by the Trial Balance. The errors detected by the Trial Balance are always in the figures, hence are corrected on the Trial Balance by drawing a line through the incorrect amount and writing the correct amount above it or on the correct side of the account. If the pencil footings or the balance written in the explanation column of the account are incorrect, erase and write the correct figures. Care must be used, however, in correcting the errors so that the equality of debits and credits will be maintained. Thus, if the error results in writing an incorrect amount in the ledger, the correction is made in the ledger, in the balance of the account in the ledger, and in the account balance listed on the Trial Balance. The column of the Trial Balance affected is again added to ascertain the effect of the correction on the amount of the error.

REPORT

Complete Report No. 21 in the work book. This is to be submitted to the instructor (a) when the errors have been corrected and the Trial Balance is in balance, and (b) when the work at the close of the fiscal period is completed. When Report No. 21 has been submitted the second time, continue with the text discussion until Report No. 22 is required on page 92.

CHAPTER VIII

SUPPLIES, INSURANCE AND EQUIPMENT

A merchant must have wrapping paper, twine and containers for use in the sale of merchandise, also equipment in the store room to display his merchandise. Equipment and office supplies are also needed in the office to facilitate the clerical work to be done there. A prudent business man will insure his property. The discussion in this chapter relates to (a) the method of recording transactions in which supplies, insurance and equipment are purchased, and (b) the method of recording at the close of the fiscal period, the expense, because of the *supplies used*, the *decrease* in value of equipment, and the *expiration* of insurance.

Supplies. Material needed in connection with the sale of merchandise and the operation of the office which will be consumed within a short period of time is referred to as *supplies*. Paper, twine, paper bags, and various types of containers will be needed in taking care of the sales of merchandise. Stationery, pencils, tablets, ink, and material of like character will be needed for the efficient operations of the office. The materials mentioned may be described as supplies or if desired to make the title more specific, *office supplies*, *store supplies*, *shipping room supplies*, *advertising material*, etc.

Purchases of Supplies. When cash is paid for supplies purchased, the transaction results in a decrease in the asset cash and an increase in the asset supplies. Since the supplies are not to be sold, the increase in the assets is not recorded in the Purchases account but in a separate account with the title Supplies.

The illustration below shows the entry in the cash book of P. A. Whitten, a retail druggist, to record a cash payment for wrapping paper and twine on November 3. The Supplies account is debited to record the increase in the asset supplies. The entry on the payments side of the cash book is a credit to the Cash account to record the decrease in the asset cash.

CASH				Payments	
19 Nov.	3	Supplies	Purchased paper and twine	21	50

When supplies are purchased on credit, the transaction results in an increase in the asset supplies and an increase in the liability accounts payable. A transaction of this nature is recorded in the general journal or in the purchases journal with a column provided for supplies.

The general journal entry in the illustration at the top of page 90 records a transaction completed by P. A. Whitten November 15 in which two gross

bottles were purchased on credit. The debit to the Supplies account records the increase in the asset supplies and the credit to the account with King Bros. records the increase in the liability accounts payable.

November 15, 19....				
91	Supplies.....	37	75	
	King Bros.....			37 75
	Purchased 2 gross bot- tles on account.			

The entry in the illustration below shows the method of recording the above transaction in a columnar purchases journal. If it is desired to enter supplies purchased in the purchases journal, it is necessary to have a column in which to record the amount of each purchase of supplies because these amounts can not be entered in the column with the purchases of merchandise since they are debits to the Purchases account.

PURCHASES JOURNAL									
November									
Date	L.F.	Account Credited	Address	Terms	Inv. Date	Accts. Pay. Cr.	Purchases Dr.	Supplies Dr.	
4		A. R. Johnson	Hamilton	20 days	11 3	177 80	177 80		
11		Day & Day	Dayton			452 30	452 30		
15		King Bros.	City			37 75		37	75

The amount of each purchase is entered in the "Accounts Payable Cr." column, the amount of each purchase of merchandise in the "Purchases, Dr." column, and the amount of each purchase of supplies in the "Supplies, Dr." column. The first two entries in the illustration record two purchases of merchandise and the third entry, the purchase of supplies referred to in the above journal entry. Should both merchandise and supplies be purchased from the same firm and included in one invoice, the amount of the invoice is entered in the first column, the amount of the merchandise in the second column, and supplies in the third.

Consumption of Supplies. The twine, wrapping paper, letterheads, envelopes, etc., are purchased for use in the daily operations of the business. Thus, the paper and twine purchased by P. A. Whitten will be used for wrapping the merchandise sold and the bottles will be used for containing medicine sold on prescriptions issued by physicians and filled by the druggist. The use of each item of supplies may be regarded as a transaction and the increase in expense and decrease in the asset supplies recorded at the time these supplies are used. This plan, however, would not be practical because of the clerical work necessary to record the use of each piece of paper, twine, bottle or other container. The usual plan is to make no record of daily expense because of supplies used but to record the entire expense in one amount at the close of the fiscal period.

Entry to Adjust the Supplies Account. The entry required at the close of a fiscal period to record as an expense the cost of all the supplies used during the fiscal period is referred to as an entry *to adjust* the Supplies account.

This adjusting entry requires a debit to an account with a descriptive title, usually *Supplies Used*, and a credit to the *Supplies* account.

The amount debited and credited is the difference between the total supplies purchased and the inventory of the supplies. The debit balance of the *Supplies* account at the close of the fiscal period shows the total purchases of supplies during the period. An inventory of supplies on hand at the close of the fiscal period ascertained by count in the same manner as the merchandise inventory shows the asset value of the supplies. Thus, at the close of the fiscal period the accountant requires the clerks to take stock of the supplies on hand and submit a list to him. From this list and the cost price he ascertains the asset value of the supplies in stock. Knowing the cost of all the supplies purchased and the cost of those which have not been used, he can easily determine the amount to be recorded in the required adjusting entry.

The account in the illustration at the right is the result of posting the two purchases of supplies made by P. A. Whitten. The balance of this account is \$59.25, the net cost of supplies purchased. At the close of the fiscal period November 30, an inventory of supplies shows the value to be \$26.75.

The illustration at the left shows (a) the journal entry necessary to adjust the *Supplies* account, and (b) the ledger accounts resulting from posting this

journal entry. You will observe that the amount debited and credited in the journal entry is the difference between the debit balance of the *Supplies* account and the amount of the inventory. When the adjusting journal entry is posted, the debit balance of the *Supplies* account shows the same amount as the inventory; the account is balanced and the balance carried down as an asset under date of the begin-

November 30, 19....									
91	Supplies Used.....			32	50				
91	Supplies					32	50		
	To record the value of the supplies used.								
SUPPLIES									
19				19					
Nov.	3	C 89	21 50	Nov.	30	J 91	32 50		
	15	J 90	37 75		30 Inv.	✓	26 75		
			59 25				59 25		
Dec.	1 Inv.	✓	26 75						
SUPPLIES USED									
19									
Nov.	30	J 91	32 50						

ning of the next fiscal period. The debit balance of the *Supplies Used* account shows the amount of the expense because of supplies used during the fiscal period. The one amount on the debit side of the *Supplies Used* account is the same as the sum of all the amounts that would have been recorded on the debit side of this account had an entry been made for each item of supplies used

daily. You can very readily see that it would not be practical for the druggist to record the cost value of each piece of paper and string used in wrapping a package or the cost value of each bottle used in filling a prescription.

Supplies Account. The purpose of this account is to contain a record of the increases and decreases in the asset supplies. It is *debited* for increases which is the cost of supplies purchased and *credited* for decreases which is the cost of supplies used. The debits are recorded at the time the purchases are made and the credit at the close of the fiscal period.

The *debit* balance of the Supplies account, before it is adjusted at the close of the fiscal period, shows the total cost of the supplies purchased and after adjustment, the asset value of the supplies on hand.

Supplies Used Account. The purpose of this account is to record the expense (decreases in proprietorship) incident to the use of all types of supplies. This expense occurs daily but is usually recorded in one amount at the close of the fiscal period. The Supplies Used account is *debited* at the close of each fiscal period for the cost value of supplies used during the period; this account is usually not *credited*. The *debit* balance of the Supplies Used account is an expense and is closed into the Profit and Loss Summary account.

It is not necessary to open an account in the ledger with Supplies Used as the debit amount may be posted to the Profit and Loss Summary account when posting the adjusting entry. This statement applies to Supplies Used, Expired Insurance, and other expenses which result from the use of deferred assets, or as they are usually termed, deferred charges. The expense accounts are shown opened in the ledger in the illustrations in this text for convenience in classifying the expenses as explained in a subsequent chapter.

REPORTS

Complete Report No. 22 in the work book and present it for approval, then complete Report No. 23. When Report No. 23 has been presented for approval, continue with the text discussion until Report No. 24 is required on page 94.

Insurance. The protection against loss on assets from fire or other causes is referred to as *insurance*. This protection is provided by insurance companies. The amount paid an insurance company for insurance is referred to as the *premium*. The payment of this premium provides the desired insurance for the contract period, usually one, three or five years. The contract executed by the insurance company in which it agrees to provide protection against loss is known as the *insurance policy*.

Prepaid Insurance. The premium is paid in advance, that is, at the time the policy is issued. The payment of cash for insurance premiums is a transaction in which the asset cash decreases and the asset prepaid insurance increases the amount of cash paid. An account with the title Prepaid Insurance is debited to record the increase in assets and the Cash account credited to record the decrease in the asset cash.

The entry in the cash book on page 93 is to record the payment of an insurance premium by P. A. Whitten, the retail druggist referred to in the previous illustration. The \$73.00 is paid November 1 but is for protection for one year.

Prepaid Insurance Account. The purpose of this account is to contain a record of the increases and decreases in the asset prepaid insurance. It is *debited* for increases which are the amounts paid as premiums on insurance and *credited* at the close of the fiscal period for the expired insurance. The *debit* balance of the Prepaid Insurance account before it is adjusted shows the total amount of the premiums paid for insurance and after it is adjusted, the asset value of the prepaid insurance at the close of the fiscal period.

Expired Insurance Account. The purpose of this account is to show the expense (decrease in proprietorship) because of expired insurance at the close of each fiscal period. It is *debited* at the close of each fiscal period for the total amount of insurance expired during the fiscal period; this account is usually not *credited*. The amount of the debit balance at the close of each fiscal period is the difference between the total premiums paid and the value of the unexpired insurance. The *debit* balance of this account is an expense and is closed into the Profit and Loss Summary account.

Some accountants record supplies and prepaid insurance as an expense at the time of purchase. When this plan is followed, the amounts of the supplies inventory and prepaid insurance at the close of the fiscal period are transferred to an account with the title Deferred Charges, with a description of each asset in the explanation column.

REPORTS

Complete Report No. 24 in the work book and present it for approval, then complete Report No. 25. When Report No. 25 has been presented for approval, continue with the text discussion until Report No. 26 is required on page 97.

Equipment. Assets other than the supplies which are consumed by their use and the merchandise purchased for sale may be needed in the operation of the business. Display cases, counters, tables and scales may be needed in the store. Typewriters, desks, adding machines and other types of office appliances may be required in the office. These assets differ from supplies in that they will not be consumed within a short time.

Containers may be consumed through use within a few days after they are purchased but a display case may be in use for several years. Office stationery such as letterheads and envelopes may be consumed by use within a few weeks or months after they are purchased but a typewriter or desk should be serviceable for several years. The assets which are not consumed within a short time are usually described as *equipment* or if a more descriptive title is desired, *office equipment*, *store room equipment*, *shipping room equipment*, and *delivery equipment*.

Purchase of Equipment. When cash is paid for equipment purchased, the transaction results in a decrease in one asset and an increase in another. Since the asset cash is decreased, the credit is to the Cash account. Since the equipment is not to be sold, the increase in assets is not recorded in the Purchases account but in a separate account with the title *Equipment*.

The illustration below shows an entry on the payments side of the cash book of P. A. Whitten, a retail druggist, to record a cash payment of \$150.00 for a display case purchased November 1.

CASH BOOK				Payments	
19					
Nov.	1	96	Equipment	Purchased display case	150 —

When this entry is posted, the Equipment account is debited for \$150.00. At the end of the month when the total cash payments is posted, the payment will be included in the total amount posted to the credit of the Cash account.

When equipment is purchased on credit, the transaction results in an increase in the asset equipment and an increase in the liability accounts payable. A transaction of this nature is usually recorded in the general journal or in the purchases journal with a column provided for equipment.

The entry in the general journal at the right is to record the purchase of a soda fountain by P. A. Whitten November 1, terms on account. The Equipment account is debited to record the increase

in the assets and the account with Dudley Bros. is credited to record the increase in the liability accounts payable. When this entry is posted, the cost of the equipment, \$600.00, will be recorded on the debit side of the Equipment account and the liability will be recorded on the credit side of the account with Dudley Bros.

It is customary when posting to the debit side of the Equipment account to write in the explanation column the title of the equipment, thus providing on the debit side of the Equipment account not only the amount of each purchase but also the nature of the equipment purchased; this plan is not necessary when a fixed asset register is used as explained in a subsequent chapter.

Estimated Depreciation. Equipment will decrease in value through use; this decrease is referred to as *depreciation*. The amount of the depreciation can not be determined until the equipment is sold, exchanged or discarded. The depreciation on equipment results in a corresponding amount of expense. Thus, if equipment costs \$500.00 and later is sold for \$300.00, the depreciation is \$200.00 and the expense resulting from the use of this equipment is \$200.00.

Since it is desired to record all the expenses for each fiscal period so that the owner may know his profit for the period, it is customary to estimate the depreciation applicable to equipment for the period. The amount of this estimated depreciation is an expense for the fiscal period and recorded as such at the close of the fiscal period. The amount of estimated depreciation could be recorded each day as an expense if desired but this would mean unnecessary clerical work; since the information is not needed until the close of the fiscal period, the total estimated expense for the period can be recorded in one amount.

November 1, 19...			
96	Equipment.....	600 —	
	Dudley Bros.....		600
	Bought 1 soda fountain on account.		

Recording Depreciation. At the close of each fiscal period the amount of the depreciation is estimated and recorded as an expense. The expense is recorded as a debit to an account with the title *Depreciation Expense*; the credit may be to the Equipment account or to an account with the title *Depreciation Reserve*.

It is customary to have the debit balance of the Equipment account show the cost value at all times because the proprietor may have occasion to refer to the cost value when purchasing new equipment or securing insurance. It is also desirable to have the Equipment account show cost value because the form of the equipment is usually the same throughout its life and it serves the same purpose as long as it is useful.

To provide for cost value in the Equipment account, it is necessary to debit the Equipment account with cost value when the equipment is purchased and credit it with cost value when the equipment is sold or discarded. The estimated depreciation at the close of each fiscal period is not recorded as a credit to the Equipment account but to an account with the title *Depreciation Reserve*. When it is desired to know the estimated present value (referred to as *book value*) of equipment, the information can be ascertained through subtracting the credit balance of the *Depreciation Reserve* account from the debit balance of the *Equipment* account.

The entry in the general journal at the right is to record the estimated expense and estimated decrease in value of the equipment owned by P. A. Whitten at the close of the monthly fiscal period, November 30. It is estimated that this equipment will be useful for ten years, hence the annual depreciation is \$75.00, and the monthly depreciation, \$6.25. This entry does not record actual facts but it does record some expense for the fiscal period because of the decrease in the value of the equipment, hence the expense recorded at the close of the fiscal period is the approximate expense for the period.

The accounts in the illustration at the left show the Equipment, Depreciation Reserve and Depreciation Expense accounts as they will appear on the ledger of P. A. Whitten after the cash book and general journal entries on page 95 and the journal entry above have been posted. You will observe that the debit balance of the Equipment

November 30, 19....

96	Depreciation Expense	6	25	
96	Depreciation Reserve			6
	To record the estimated depreciation.			25

EQUIPMENT

19									
Nov.	1	C	95	150	—				
	1	J	95	600	—				

DEPRECIATION RESERVE

			19						
			Nov.	30	J	96	6	25	

DEPRECIATION EXPENSE

19									
Nov.	30	J	96	6	25				

account shows the cost of the equipment, the credit balance of the Depreciation Reserve account, the estimated decrease in value because the equipment has been used one month, and the Depreciation Expense account, the amount recorded as an expense for the month because of this depreciation. If it is desired to know the estimated book value of the equipment November 30, it can be ascertained from the account balance as follows: \$750.00 — \$6.25 or \$743.75.

Equipment Account. The purpose of this account is to contain a record of the increases and decreases in the asset equipment. It is *debited* for the cost of equipment purchased and *credited* for the cost of equipment sold or discarded. The *debit* balance of the Equipment account shows the cost value of the equipment owned but is not all an asset after the first fiscal period; the asset value (book value) is the difference between the debit balance of the Equipment account and the credit balance of the Depreciation Reserve account.

Depreciation Reserve Account. This is an asset account related to the Equipment account in that the credits are deductions from the debit balance of the Equipment account. The purpose of the Depreciation Reserve account is to contain a record of the book value of the equipment. It is *credited* at the close of each fiscal period for the estimated decrease in value of the equipment because of depreciation, and *debited* for the depreciation reserve applicable to equipment when it is sold or discarded.

The debit balance of the Equipment account, the credit balance of the Depreciation Reserve account, and the book value (difference between the two account balances) of the equipment are each shown on the Balance Sheet.

Depreciation Expense Account. The purpose of this account is to contain a record of the estimated expense (decrease in proprietorship) because of the estimated depreciation in the value of the equipment. The Depreciation Expense account is *debited* at the close of each fiscal period for the amount of the estimated depreciation credited to the Depreciation Reserve account; it is usually not *credited*. The *debit* balance of the Depreciation Expense account is an expense and is closed into the Profit and Loss Summary account.

REPORTS

Complete Report No. 26 and present for approval, then complete Report No. 27. When Report No. 27 has been presented for approval, continue with the text discussion until Report No. 28 is required on page 105.

CHAPTER IX

NOTES AND INTEREST

When it is not possible to collect the cash from a charge customer at the time his account is due and he wishes additional time, it is customary to grant this request upon receipt of a written promise by him to pay the amount at a definite future time. When the proprietor of a business does not have the cash with which to pay a creditor at the time his account is due, additional time may be secured through a written promise to pay at a definite date in the future. When the proprietor needs money and can not collect it from his charge customers, he may borrow the money from a bank provided he will give the bank written evidence of the loan. The discussion in this chapter relates to (a) the method of recording transactions in which additional time is allowed to a customer and by a creditor through written promises, and (b) transactions in which money is borrowed from a bank.

Promissory Note. An unconditional written promise to pay a fixed amount of money at a stated time signed by the person or persons agreeing to pay it is referred to as a *promissory note* or a *note*. The day the note is issued is referred to as the *date*, the day it is due as the *maturity*, the number of days, months or years between the date and maturity as the *time*, the amount stated in the note as the *face*, the one who signs the note as the *maker*, and the one to whom the note is payable as the *payee*.

The extension of time required is usually granted only when the one to whom it is granted agrees to pay for the use of the money; this use is usually referred to as *interest*. Thus, if it is not possible to collect from a charge customer at the time the amount of his account is due and additional time is granted through a note signed by him, he will be required to agree in this note to pay interest for the use of the money. In the same way if the proprietor needs more time in which to pay a creditor an amount due, he will issue a note for the amount and agree in the note to pay interest for the use of the money. If the proprietor wishes to borrow money from the bank, he will have to pay interest for the use of the money.

There are two kinds of notes; (1) those which are interest-bearing and (2) those which are non-interest-bearing. The use of the words "With interest" is sufficient to make a note interest-bearing but the rate of interest should also be stated so as to avoid any misunderstanding in regard to it. No mention of interest in a note means that it is non-interest-bearing.

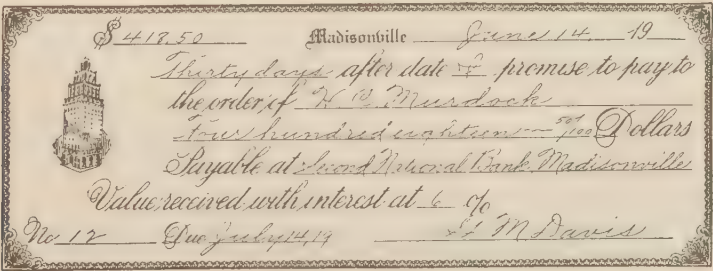
The face of a note is the amount stated in the note. The amount to be collected at the maturity of the note is referred to as the maturity value of the note. The maturity value of the note is the same as the face if the note is non-interest-bearing. If the note is interest-bearing the maturity value is more than the face because of the promise to pay interest.

Notes Receivable. A promissory note owned by the proprietor of a business is referred to as a *note receivable*. A note receivable is usually made payable to the proprietor though it may be made payable to a third party and transferred to him by indorsement. Notes receivable are usually received from charge customers for the purpose of securing an extension of time on an account which is due or past due. The note receivable is usually signed by the charge customer and made payable to the proprietor of the business; it may be interest-bearing or non-interest-bearing. Whether interest-bearing or non-interest-bearing, the face of the note is always recorded.

The account with G. M. Davis, a charge customer of H. C. Murdock, as it appears on the ledger of H. C. Murdock is in the illustration at the right. You will observe that the amount of the indebtedness, \$418.50, is the result of a sale made May 15, terms, 30 days, hence it matures June 14. The cash can not be collected from G. M. Davis on this date but he is willing to execute a written promise to pay the amount thirty days from June 14 and to pay interest at 6% for the use of the money.

The note in the illustration below was received by H. C. Murdock from G. M. Davis as evidence of this 30 days extension. In other words, G. M. Davis

		G. M. DAVIS		Madisonville	
19	May	15	30 days	418	50



can not pay cash June 14 but he is reasonably sure that he can pay it July 14 and has stated this fact in writing. The date of this note is June 14, the time thirty days, the maturity July 14, the maker G. M. Davis, the payee H. C. Murdock, the rate of interest 6%, the face \$418.50, and the maturity value \$420.59. The note is payable at the Second National Bank of Madisonville but H. C. Murdock can require it paid at any other bank or his office.

Recording a Note Receivable. When a note receivable is received from a charge customer, it does not cancel his obligation to the business. It does, however, provide the business with a different type of asset. The accounts receivable is an asset but it is only the seller's record, hence subject to dispute. The note, on the other hand, is a written promise signed by the charge customer, hence the amount is fixed and not subject to dispute as the account might be. These written promises are assets referred to as *notes receivable*.

When a note is received from a charge customer, the transaction results in an exchange of one asset for another; the asset accounts receivable decreases and the asset notes receivable increases. Since asset accounts are debited for increases and credited for decreases, it is quite evident that the Notes Receivable account is debited for the face of the note and the account with the charge customer (accounts receivable) credited for the face of the note.

The entry in the illustration at the right is that required in the general journal of H. C. Murdock to record the note received from his charge customer, G. M. Davis. The debit to the Notes Receivable account records the increase in the asset notes receivable and the credit to the account with G. M. Davis records the decrease in the assets accounts receivable. The face of a note is always recorded when the note is received because it is the amount stated in the note. This is true whether the note is interest-bearing or non-interest-bearing.

June 14, 19...			
Notes Receivable.....	418 50		
G. M. Davis.....		418 50	
Received 30 day 6% note in full of account.			
	"	"	"

Collecting a Note Receivable. The maker of a note promises to pay the amount stated in the note to the payee at maturity. If the payee holds the note at maturity, he should notify the maker a few days before maturity so that he may be reminded of the maturity, know the amount he is to pay and where to pay it. Should the payee transfer the note to another before maturity, the one to whom it is transferred, usually referred to as the *holder*, should notify the maker a few days before maturity.

When cash is received from the maker of the note at maturity, the amount received will be either (a) the face of the note, or (b) the maturity value which is the face plus the interest. The receipt of cash for the face of a non-interest-bearing note is a transaction in which the asset cash increases and the asset notes receivable decreases each for the face of the note. When cash is received for collection of an interest-bearing note, the transaction results in an increase in the asset cash for the amount received, a decrease in the asset notes receivable for the face of the note, and an increase in proprietorship referred to as *interest income* for the amount of the interest.

The entry on the receipts side of the cash book illustrated below is to record collection by H. C. Murdock at maturity of the note received from G. M. Davis June 14. The Notes Receivable account is credited for the face of the note to record the decrease in the asset notes receivable and the Interest Income account is credited to record the increase in proprietorship. The entry on the receipts side of the cash book records the debit to the Cash account for \$420.59, the amount received.

		CASH		Receipts
19				
July	14	Notes Receivable	G. M. Davis note	418 50
	14	Interest Income	Interest on above note	2 09

Collection Charges on a Note. Notes receivable are usually collected through a bank, preferably the one at which the maker does business. Thus, a few days before a note is due, the holder will indorse it to the collecting bank "For collection" and send it to the bank with request to collect it.

The bank will notify the maker that the note is held by it for collection and when it collects from the holder, will notify the payee that collection has been made and inclose with this notice remittance for the amount collected less a small fee for making collection. The amount of this fee will be an expense to the payee of the note and is usually referred to as *collection expense*.

Assuming that H. C. Murdock sent the note signed by G. M. Davis to the bank at which it is payable for collection and that G. M. Davis paid the bank at maturity the maturity value of the note, the procedure is explained in the following illustrations.

The letter in the illustration at the left is advice to the Second National

WE DELIVER PROMPTLY	PHONE PLAINFIELD 296
H. C. MURDOCK "Only the Best" GROCERY AND DAILY MEAT MARKET	
LEXINGTON July 12, 19	
Second National Bank Madisonville	
Gentlemen:	
Enclosed find a 6% interest-bearing note for \$418.50, signed by G. M. Davis, your city. You will observe that the note matures July 14.	
Please present this note for collection and remit proceeds.	
Yours very truly,	
H. C. Murdock	
HCM:D	

Bank, Madisonville, regarding the note which is to be collected. If desired, a copy of this letter may be mailed to the maker of the note so that he may expect notice from the bank and be prepared to pay the note. While the holder of the note or his agent is not required to notify the maker, yet it is only business courtesy that he should be notified a few days before the maturity of the note so that he may know where to pay it.

The illustration at the right shows the indorsement which H. C. Murdock will place on the note before he sends it to the bank for collection. It is necessary to transfer title of the note to the bank through indorsement so that the bank may collect it. This transfer, however, is restricted through the words "For collection", hence is referred to as a *restrictive indorsement*.

Pay to the order of
Second National Bank
For collection
H C Murdock

When the bank receives the note, it will record it as a collection for H. C. Murdock and the maker, G. M. Davis, will be notified. The illustration at

BRING THIS NOTICE WITH YOU

SECOND NATIONAL BANK

Capital \$100,000.00

July 13, 19

Your (Acceptance)
Note for \$ 418.50 will be due at
this bank July 14, 19

Your early attention will oblige.

W. H. Frazier
Cashier

the left shows one form of printed notice used by the bank for notifying the maker about the maturity of a note. If G. M. Davis has received a copy of the letter which H. C. Murdock wrote the bank, he will be expecting this notice. Both the letter from H. C. Murdock and the notice from the bank are reminders of the indebtedness and the amount.

As a result of the courtesies extended through both notices, G. M. Davis calls at the bank and pays the note. Since the note belonged to H. C. Murdock, the bank will report collection to him and send remittance for the proceeds, which is the amount collected less the collection charges. The illustration at the right is a notice sent by the bank to H. C. Murdock. It contains full information regarding the paper collected and the form of remittance which accompanies it.

SECOND NATIONAL BANK

MADISONVILLE July 14, 19

PLEASE NOTE THAT COLLECTIONS HAVE BEEN MADE AS FOLLOWS

DATE	NAME AND ADDRESS	AMOUNT	CREDIT
July 14	G. M. Davis, Madisonville	420.59	420.09

Cashier's check for \$420.09 enclosed

To H. C. Murdock
Lexington

ALL ITEMS CREDITED SUBJECT TO FINAL PAYMENTS

The cashier's check accompanying the notice is in the illustration on page 103. You will observe that the bank collected the maturity value of the note

but the notice and cashier's check both state that H. C. Murdock is to receive fifty cents less than this because of the collection charges.

MADISONVILLE JULY 14 19 No. 387

THE SECOND NATIONAL BANK 65-20

PAY TO THE ORDER OF H. C. MURDOCK \$ 420.09

CASHIER'S CHECK W. H. Ingersoll

DOLLARS CASHIER

The entries in the general journal and the cash book below are to record the cashier's check received by H. C. Murdock. The Cash account is debited to record the increase in the asset cash, the Collection Expense account is debited to record the increase in expense because of collection expense, the Notes Receivable account is

July 14, 19...

credited to record the decrease in the asset notes receivable and the Interest Income account is credited to record the increase in proprietorship. The

✓ Cash.....	420 09	
Collection Expense.....	50	
Notes Receivable.....		418 50
Interest Income.....		2 09
Proceeds of G. M. Davis note.		

proceeds of the note is recorded on the receipts side of the cash book. Check marks are placed in the folio column of the Cash entry in the general journal and the Notes Receivable entry in the cash book to avoid double posting.

				CASH	Receipts
19					
July	14	✓	Notes Receivable	Proceeds of G. M. Davis note	420 09

If desired, the entry may be made on both sides of the cash book instead of in the general journal and cash book. If recorded in this manner, the face of the note and the interest will be recorded on the receipts side of the cash book and the collection charges on the payments side. Since it is desired to have the receipts side of the cash book show actual cash received and the payments side show actual cash paid and since recording the transaction as suggested in the preceding sentence would not show this fact, the general journal and cash book entry is preferred.

Partial Payment of a Note Receivable. When the amount of the note can not be collected from the maker at maturity and additional time is granted on a part of it, it is customary to require a new note as evidence of the extension of time. The entries in the general journal and cash book at the top of page 104 are to record a check and a new 60-day 6% note for \$300.00

received by H. C. Murdock from G. M. Davis in settlement of note due June 14, it being assumed that

G. M. Davis, the maker, could not pay all of the note. The Cash account is debited to record the increase in the asset cash, the Notes Receivable account debited for the face

July 14, 19			
√	Cash.....	120 59	
	Notes Receivable.....	300 00	
	Notes Receivable		418 59
	Interest Income.....		2.09
	Received check and 60 day 6% note in pay- ment of note due today.		

of the new note, the Notes Receivable account credited for the face of the old note because it is now canceled, and the Interest Income account credited to record the increase in proprietorship which is interest on the old note for thirty days. The cash book entry and Cash in the general journal are checked to avoid double posting.

		CASH		Receipts	
19 July	14	√	Notes Receivable	Part payment G. M. D. note	120 59

Indorsement of Notes. A note may be indorsed (a) to transfer the title, (b) as security, (c) for part payment, and (d) for collection. Indorsements are written on the back in the same manner as indorsements on checks. An indorsement for security may be written on the face of the note below the name of the maker provided the surety writes "surety" after his name.

An indorsement to transfer title may be made in blank or in full. An indorsement for security is usually made in blank. An indorsement for part payment contains the date and amount of payment; no name should appear in connection with this indorsement because it might be interpreted as surety. An indorsement for collection includes "for collection" or "for collection and credit", the name of the collecting agent and the name of the one for whom the note is collected. Each indorser for transfer of title on a note is responsible for payment unless *without recourse* is written with the indorsement; it is then known as a *qualified indorsement*. The form of the indorsement made for collection is shown in the illustration on page 102. The form of any other indorsement is the same as that for a check as illustrated on page 42.

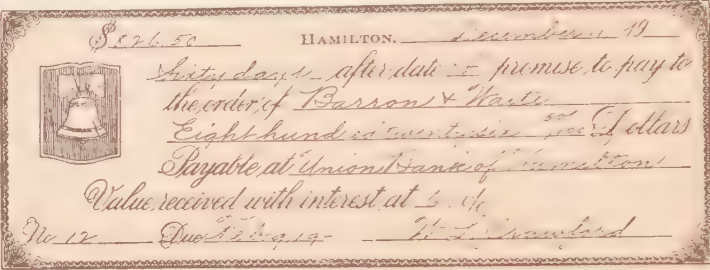
Notes Receivable Account. The purpose of this account is to contain a record of the increases and decreases in the asset notes receivable. The Notes Receivable account is *debited* for increases which is the face of each note when received and *credited* for decreases which is the face of each note when collected or discounted.

The *debit* balance is the asset notes receivable and agrees with the sum of all notes owned by the business less partial payments.

When partial collection is made on a note receivable and the remainder of the note is not renewed, the partial payment is indicated in the Notes Receivable account by letters the same as an account receivable. When the note receivable is collected in full, the sum of the amounts indicated by the same letter on the credit side will correspond with the face of the note indicated by the same letter on the debit side.

have sufficient cash to pay the account on December 11 but is reasonably sure that he can pay within sixty days. Barron & Waite, the firm to whom he owes the account, agree to extend the time sixty days, provided W. L. Crawford will give them a 6% interest-bearing note for the amount.

The note in the illustration below was issued by W. L. Crawford in accordance with the agreement with Barron & Waite. The note will be removed from the stub and sent to Barron & Waite. The stub contains a record of the note and is retained by W. L. Crawford as a basis for the entry to record the note.

Amount \$ <u>826.50</u>	
Date <u>December 11, 19</u>	
Time <u>60 days</u>	
In favor of <u>Barron & Waite</u>	
Payable at <u>Union Bank</u>	
Interest <u>6 %</u> from <u>Dec 11, 19</u>	
Due <u>February 9, 19</u>	
No. <u>12</u>	

The illustration at the right shows the form of entry in the general journal of W. L. Crawford to record the extension of time granted by Barron & Waite and the note issued as evidence of this extension. The debit to the account with Barron & Waite records the decrease in the liability accounts payable and the credit to Notes Payable records the increase in the liability notes payable. In other words, issuing a note to a creditor to secure an extension of time is a transaction in which the liability accounts payable decreases and the liability notes payable increases. The face of the note payable is always recorded at the time the note is issued whether the note is interest-bearing or non-interest bearing. No record is made of the interest in an interest-bearing note until maturity.

December 11, 19....

Barron & Waite.....	826.50	
Notes Payable.....		826.50
Gave 60 day 6% note in full of account.		

Payment of a Note Payable. A few days before maturity the proprietor who has issued a note in order to secure an extension of time will receive a notice from the holder of the note so that he may know where to pay it and the amount to pay; the amount is always the maturity value of the note which is the face if non-interest-bearing or the face plus the interest if interest-bearing. When an interest-bearing note is paid, the transaction results in a decrease in the asset cash, a decrease in the liability notes payable, and a decrease in proprietorship for the amount of the interest. Since the interest is paid for the use of the money, it is a decrease in proprietorship, usually referred to as *interest expense*.

The entry in the illustration below records the payment at maturity of the note February 9. Since the note is interest-bearing, rate 6%, the maturity value is \$834.77.

CASH				Payments
19				
Feb.	9	Notes Payable	Barron & Waite note	826.50
	9	Interest Expense	Int. on above note	8.27

The Notes Payable account is debited to record the decrease in the liability notes payable and the Interest Expense account is debited to record the decrease in proprietorship. The entry on the payments side of the cash book records the decrease in the asset cash.

Usually the amount paid by the maker of a note is the maturity value of the note whether he pays it to a collecting bank or to the payee; collection charges are usually paid by the holder of the note.

Borrowing Money from the Bank. When the proprietor of a business needs cash, he usually borrows it from the bank with which he does business. The usual process of securing a loan from the bank is for the proprietor to issue to the bank a non-interest-bearing note for the amount of the loan, present it to the bank and receive credit (in the same manner as he receives credit for a deposit) for the proceeds of the note which is the face less the agreed rate of interest for the time of the loan. Under these conditions the transaction results in an increase in the asset cash for the proceeds, an increase in the liability notes payable for the face of the note, and a decrease in proprietorship (interest expense) for the amount of the interest. The Cash account is debited to record the increase in the asset cash, the Interest Expense account debited to record the increase in expense, and the Notes Payable account credited to record the increase in the liabilities. The entry is made in the general journal and receipts side of the cash book or on the receipts and payments side of the cash book.

January 9. W. L. Crawford wishes to borrow \$2000.00 from the Union Bank. The cashier of the bank agrees to make the loan at the rate of 7%. The note in the illustration below was issued by W. L. Crawford as evidence of the loan. The note is presented to the bank and the stub retained as a basis for the entry to record the transaction.

Amount \$ <u>2000.00</u> Date <u>January 9, 19</u> Time <u>90 days</u> In favor of <u>Union Bank</u> Payable at <u>Union Bank</u> Interest <u>7%</u> from Due <u>April 9, 19</u> No. <u>13</u>	 \$ <u>2000.00</u> HAMILTON <u>January 9, 19</u> <u>Ninety days after date I promise to pay to</u> <u>the order of Union Bank</u> <u>Two thousand</u> ^{no} / ₁₀₀ <u>Dollars</u> <u>Payable at Union Bank of Hamilton</u> <u>Value received with interest at no. 10</u> <u>No. 13 Due April 9, 19</u> <u>W. L. Crawford</u>
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The general journal and cash book entries illustrated below record the transaction. The Cash account is debited to record the increase in the asset cash, the Interest Expense account is debited to record the increase in expense and the Notes Payable account is credited to record the increase in liabilities. The amount of the interest, \$35.00, is 7% on \$2,000.00 for 90 days, the time of the loan. The entry in the cash book is to record the cash received. The check marks in the folio column in the cash book and general journal are to avoid double posting.

January 9, 19....			
✓	Cash.....	1965—	
	Interest Expense.....	35—	
	Notes Payable.....		2000—
	Borrowed \$2,000.00 from the bank.		

CASH					Receipts	
19	Jan.	9	✓	Notes Payable	Proceeds of note	1965 —

If desired, this entry may be recorded on the receipts and payments side of the cash book instead of the general journal and receipts side of the cash book. When made in the cash book only, the Notes Payable account is credited with the face of the note on the receipts side and the Interest Expense account is debited for the amount of the interest on the payments side. This records the same facts but it does not permit the record on the receipts side of the cash book to show total cash received and on the payments side to show total cash paid, hence the general journal and cash book entry are preferable.

Partial Payment of a Note Payable. When the proprietor can not pay a note at maturity, he may secure an extension of time on a part of it through issuing a new note, usually interest-bearing. A transaction of this nature results in a decrease in the liability notes payable for the face of the old note, a decrease in the asset cash for the amount of cash paid on the note, an increase in interest expense for the interest on the old note, and an increase in the liability notes payable for the face of the new note.

The general journal entry in the illustration at the left below and the cash book entry at the top of page 109 are required to record the renewal by W. L. Crawford of a part of the 60-day note issued to Barron & Waite December 11. It is assumed that a 60-day 6% note for \$500.00 and a check for

February 9, 19....				\$334.77 are sent to Barron & Waite in settlement of the old note. The Notes Payable account is debited for the face of the old note to record the decrease in the liability, the Interest Expense account is	
	Notes Payable	826 50			
	Interest Expense	8 27			
	Notes Payable		500 —		
✓	Cash.....		334 77		
	Gave check and 60 day 6% note in payment of note due today.				

debited for the interest on the old note to record the interest expense, the Cash account is credited to record the amount of the check (decrease in the asset cash) and the Notes Payable account is credited for the face of the new note to record the increase in the liability notes payable. The check is recorded in the cash book as a debit to the Notes Payable account, hence check marks are placed in the folio column of the cash book entry and in the Cash account in the general journal entry to avoid double posting.

CASH				Payments
19	Feb.	9	✓ Notes Payable	Part payment B. & W. note
				334 77

Notes Payable Account. The purpose of this account is to contain a record of the increases and decreases in the liability notes payable. This account is *credited* for increases which is the face of each note payable signed by the proprietor and *debited* for decreases which is the face of each note paid by the proprietor.

The *credit* balance is the liability notes payable and agrees with the sum of the unpaid notes payable less partial payments. Partial payments are indicated in the account in the same manner as notes receivable.

Interest Expense Account. The purpose of this account is to contain a record of the expense (decrease in proprietorship) because of interest paid to others. This account is *debited* for increases in interest expense; it is usually not *credited*.

The *debit* balance of the Interest Expense account is an expense and is closed into the Profit and Loss Summary account.

Interest Calculations. Interest calculations require knowledge of (a) the principal on which the interest is to be paid or collected, (b) the time, and (c) the rate. The principal is the amount on which the interest is to be calculated usually the face of the note. The rate is the agreed or legal rate. The interest to be paid or collected is the principal multiplied by the rate expressed as a decimal fraction, if the time is one year; if the time is more or less than a year, the interest is proportionately more or less.

The *time* between two dates includes the number of days beginning with the next day after the first day and including the last day of the period. Thus, the method of ascertaining the time between April 16 and July 14 would be as in the illustration at the right. The date subtracted from the number of days in the month gives the remaining number of days in that month. The number of days in each succeeding month and the number of days in the ending month added to the number of days remaining in the beginning month is the number of days for which interest is computed.

April	30 days
April	16 date
	—
	14 days
May	31 days
June	30 days
July	14 days
	—
	89 days

Sixty-day, Six Per Cent Method. For convenience when making interest calculations, it is customary in business to regard a year as 360 days. Thus, if the interest rate is 6%, this means 6/100 of the principal for 360 days. If the time is only 180 days, the interest would be only one-half the interest for a year; if 90 days, one-fourth; if 60 days, one-sixth.

The interest on \$2000.00 for one year at 6% is 6/100 of \$2000.00 or \$120.00. The interest on \$2000.00 for 60 days at 6% is 1/6 of the interest for one year or \$20.00. The interest on \$2000.00 for 6 days is 1/10 of the interest for 60 days or \$2.00. Thus, the interest on \$2000.00 for one year at 6% is \$120.00, for 60 days, \$20.00, and for 6 days, \$2.00.

The "6% 60 day" method is based on the fact that the interest on any amount for 60 days at 6% is 1/100 of the amount and the interest for 6 days is 1/1000 of the amount.

Interest on \$418.75 for 6 days = \$0.41875
54 days, the time ÷ 6 = 9
\$0.41875 × 9 = \$3.77

Thus, the interest on \$1,247.75 for 60 days is \$12.48 and for 6 days,

\$1.25. The illustration at the left shows the method of ascertaining the interest on \$418.75 for 54 days at 6%. The interest for 6 days is \$0.41875 and since 6 is contained into 54, 9 times, the interest for 54 days is \$0.41875 × 9 = \$3.77.

The interest on \$417.28 for 72 days at 6% and at 8% is ascertained as in the illustration at the right. The interest at 8% is one-third more than 6%, hence adding one-third of the interest at 6% gives the amount when the rate is 8%.

Interest on \$417.28 for 60 days =	\$4.1728
Interest on \$417.28 for 6 days =	.41728
Interest on \$417.28 for 6 days =	.41728
Interest on \$417.28 for 72 days =	\$5.00736
\$5.00736 ÷ 3 =	1.66912
Interest at 8% for 72 days =	\$6.67648

REPORT

Complete Report No. 29 in the work book and present for approval, then complete Report No. 30. When Report No. 30 has been presented for approval, continue with the text discussion until Report No. 31 is required on page 116.

CHAPTER X

COMMERCIAL DRAFTS

The term draft is used to describe two different business forms, (1) bank drafts, and (2) commercial drafts. A bank draft, as previously explained, is a check drawn by one bank on funds deposited in another bank. The discussion in this chapter relates to (a) commercial drafts and their use for collecting past due accounts and C. O. D. freight shipments, and (b) trade acceptances and their use in connection with sales.

Commercial Drafts. When the creditor and debtor are both located in the same city, the creditor can present his claim to the debtor in person if the debtor does not call and pay the claim. When the debtor resides in a different city, the creditor can not very well present his claim in person, hence usually collects through correspondence. If the debtor does not send remittance as a result of correspondence, it is necessary for the creditor to use some other means of making collection. The usual means is through a commercial draft also known as a *draft*.

A written order signed by a creditor requesting his debtor to pay the amount of his indebtedness to a third party, usually a bank, is referred to as a *draft*. The creditor who draws the draft is referred to as the *drawer*, the charge customer on whom the draft is drawn, as the *drawee*, and the collecting bank, as the *payee*. The purpose of a draft is to secure collection of an amount which is past due and which can not be collected through a personal call or correspondence; a draft is unnecessary when collection is made at maturity of a debt or when the debtor resides in the same city with the creditor. It is customary for the creditor to secure permission from the debtor to draw the draft or at least to notify him that a draft will be drawn at a definite date in the future, thus giving him an opportunity to pay the claim without the draft, if he desires to do so.

When the creditor wishes the indebtedness paid upon presentation of the draft, it is drawn payable *at sight* and known as a *sight draft*. When the creditor wishes to allow additional time for payment after the draft is presented, it is made payable a designated number of days after date or after sight; this form is referred to as a *time draft*. A sight draft is *honored* when the drawee pays it upon presentation and *dishonored* when he refuses payment. A time draft is *honored* when accepted by the drawee and *dishonored* when acceptance is refused.

Illustration. The use of a sight draft as a means of collecting past due accounts is further explained by illustrations. The account in the illustration at the right appears on the ledger of Canton Bros., wholesale merchants in Buffalo. The "City National Bank" in connection with the title is the bank at which J. A. Barton does business. The accountant ascertained the name of the bank from the check received May 8 and wrote it on the account so that in case it was necessary to collect through a draft, he would know the bank at which the customer did business.

J. A. BARTON								Utica	
City National Bank									
19				19					
Mar.	9	60days	\$27	196	50	May	8	C28	196 50
May	9	60days	\$96	581	86	July	1	C45	150 —
						Aug.	1	C62	100 —
						Sept.	1	C74	100 —

October 10, it is desired to collect the balance due from J. A. Barton. The usual procedure is as follows:

- (1) A letter is written to J. A. Barton requesting remittance for \$181.86, the amount past due.
- (2) If no reply is received in ten days, another letter is written October 20 stating that a sight draft will be drawn October 25 through the City National Bank of Utica for \$181.86 unless remittance is received by that date.
- (3) If J. A. Barton does not answer this letter, the draft illustrated below is drawn and sent to the bank with a letter of explanation, also a letter is written to J. A. Barton advising him that the draft has been drawn as suggested in letter of October 20.

Amount \$ 181.86

Date October 25, 19

Time Sight

Favor City National Bank
Utica

Drawee J. A. Barton
Utica

No. 7

NO PROTEST "KAR THIS OFF BEFORE PRESENTING"

Buffalo

October 19

Pay to the

Order of

City National Bank of Utica

Payable to order

Value received and charge to account of

To J. A. Barton

No. 7

181.86

Canton Bros.

Utica

You will observe that this draft is a written request signed by Canton Bros. in which they ask J. A. Barton to pay \$181.86 to the City National Bank of Utica. This is only a request, hence no change takes place in the assets and proprietorship of Canton Bros. for which reason no entry is required in the journal. The draft stub is retained as a record of the draft. If desired, the accountant may write in the explanation column of the account "Sight draft for balance drawn October 25."

When the bank receives the draft, a messenger from the bank will present it to J. A. Barton for collection. If J. A. Barton pays the draft when presented,

it is said to be *honored*; if he does not pay it upon presentation, it is said to be *dishonored*.

When the draft is honored, the messenger sent by the bank receives a check for the amount and leaves the draft with J. A. Barton as a receipt. The bank then reports the collection to Canton Bros. and sends a remittance (a bank draft or cashier's check) for the amount of the draft less collection charges.

If J. A. Barton refuses to grant the request of Canton Bros. through dishonoring the draft, the messenger will bring the draft back to the bank and it will be returned to Canton Bros. Attached to the draft when returned will be a slip on which the bank has noted the reason J. A. Barton gave the messenger for not paying the draft; this may be "Have sent check", "Will send check direct", "Do not honor sight drafts", "Draw again November 1" or various other reasons.

When the draft is honored and Canton Bros. receive a remittance from the bank, this remittance will constitute a transaction because it results in a decrease in the asset accounts receivable and an increase in the asset cash. If the amount of the remittance is less than the draft because of collection charges, there will also be a decrease in the proprietorship for the amount of the collection charges.

Assuming that October 28 Canton Bros. received a remittance from the bank for \$181.36 with a statement showing the reason for the remittance and the amount of the collection charges, the transaction would be recorded as shown in the general journal entry at the right and the cash book entry below. It is necessary to record the transaction in both the general journal and cash book because of the collection charges as explained on page 101.

October 28, 19...			
✓	Cash.....	181 36	
	Collection Expense.....	50	
	J. A. Barton.....		181 86
	Collected J. A. Barton draft.		

CASH					Receipts	
19	Oct.	28	✓	J. A. Barton	Proceeds of draft	181 36

Check marks are used to avoid double posting. You will observe that when a check mark is placed in the folio column on a line with an account to be debited in one journal that a corresponding check mark is placed in the folio column on a line with an account to be credited in another journal; in other words, check marks used to avoid double posting are always in pairs.

If the draft is dishonored by J. A. Barton, hence returned by the bank to Canton Bros., there is no transaction to record because no change has occurred in the assets or proprietorship. Whether the draft is honored or dishonored, some notation should be made on the stub of the draft when the report is re-

ceived from the City National Bank. The usual plan is to write on the stub "Honored" and the date the remittance is received if the draft is honored, or "Dishonored" and the date the draft was returned if it is dishonored.

Each draft is written on one of the blanks in a book containing blank drafts and stubs. Information regarding each draft drawn is recorded on the stub, and the draft is removed and sent to the collecting bank. From time to time the accountant will examine the stubs in the draft book to determine whether collecting banks are giving prompt attention to drafts. He knows from the information on the stubs of the drafts reported that they have been taken care of and can determine from the date on the stubs of those which have no notation whether sufficient time has elapsed for receiving a report of collection or the return of the draft.

Time Draft. A draft made payable a designated number of days after presentation or after date is referred to as a *time draft*. A time draft dated October 9, payable at 30 days *sight* and presented for acceptance October 11, if honored on that date, will mature November 10. A time draft dated June 5, payable 30 days after *date*, presented for acceptance June 7 and honored on that date will mature July 5. Time drafts are used only when the charge customer will not honor a sight draft. Thus, if in response to a request for the privilege of drawing a sight draft, the charge customer states that he can not honor a sight draft when presented but he will honor a 30-day time draft, his request is granted if the time draft is drawn as requested.

The procedure in drawing a time draft and securing its acceptance is the same as for a sight draft. The draft is made payable to a bank, preferably the one at which the charge customer does business, and is sent to the bank for presentation and acceptance. The drawee of a time draft honors it upon presentation by writing across the face "Accepted, the date, the bank at which it is payable, and his name"; see acceptance on the time draft illustrated on page 115. The accepted draft is either returned to the drawer or retained by the bank for collection at maturity. If the draft is dishonored (not accepted) upon presentation, it is returned by the bank to the drawer with the reason given by the drawee in the same manner as a dishonored sight draft.

The receipt of an accepted time draft or notice from the collecting bank that a time draft has been accepted and is retained by the bank for collection is to the drawer a transaction in which the asset accounts receivable decreases and the asset notes receivable increases. The time draft is a note receivable when honored because it is the written promise of the drawee to pay a definite amount at a stated time.

If the honored time draft is returned to the drawer by the bank, the drawer will hold the draft until a few days before maturity and return it to the bank for collection. Thereafter the procedure is the same as that explained on page 100 relative to the collection of a note.

Illustration. The account in the illustration at the right appears on the ledger of Canton Bros. The charge customer has not responded to letters and it is desired to collect through a draft. October 1 a letter was written requesting the privilege of drawing at sight for \$221.50 October 10. October 8 a reply was received to this letter in which the charge customer stated that he could not honor a sight draft but would honor a 60-day time draft. He is advised October 8 in reply to this letter that the request is granted and a draft at 60 days sight has been drawn through the City National Bank for \$221.50.

The draft illustrated below was drawn, removed from the stub and mailed to the City National Bank together with a letter explaining its purpose.

M. D. WALTERS									
City National Bank					Troy				
19					19				
May	10	60days	S30	421 50	July	1	C48	100	—
					Aug.	1	C62	50	—
					Sept.	1	C74	50	—

Amount \$ 221.50

Date October 8, 19

Time 60 days sight

Favor City Nat'l Bank, Troy

Drawee M. D. Walters

Troy

No. 6

NO PROTEST. TEAR THIS OFF BEFORE PRESENTING

\$ 221.50

BUFFALO October 8, 19

At sixty days sight Pay to the

Order of City National Bank of Troy

Two hundred twenty-one WITH EXCHANGE and one The Dollars

Value received and charge to account of

To M. D. Walters } Canton Bros

No. 6 Troy } H. B. Canton

You will observe that this is only a request made in the same form as the sight draft. The distinction is that M. D. Walters, the drawee, will have sixty days from the date the draft is honored in which to pay the amount while in the case of the sight draft the drawee would have to pay the amount of the draft in order to honor it.

When the draft is received by the City National Bank it will be presented to M. D. Walters by a messenger of the bank and, if he complies with the promise in his letter, it will be honored by him. A time draft is honored

Amount \$ 221.50

Date October 8, 19

Time 60 days sight

Favor City Nat'l Bank, Troy

Drawee M. D. Walters

Troy

No. 6

\$ 221.50

BUFFALO October 8, 19

At sixty days sight Pay to the

Order of City National Bank of Troy

Two hundred twenty-one WITH EXCHANGE and one The Dollars

Value received and charge to account of

To M. D. Walters } Canton Bros

No. 6 Troy } H. B. Canton

through the drawee *accepting* it, that is, stating in writing that he will pay the draft at maturity. Usually the place at which it is to be paid is also stated in connection with the acceptance.

If M. D. Walters honors the draft when presented the bank will return the accepted draft to Canton Bros. with its report. The draft in the illustration at the bottom of page 115 is the same as that in the illustration above it except it contains the drawee's acceptance; a time draft which has been accepted by the drawee is referred to as an *acceptance*. You will observe that the draft is placed in position to compare with the stub and that the proper notation has been made on the stub.

Should the drawer fail to comply with the promise made in his letter, the dishonored draft will be returned to the drawer by the collecting bank.

The receipt of this accepted draft is a transaction to Canton Bros. because it causes a change in the asset accounts receivable and in the asset notes receivable; the asset accounts receivable decreases and the asset notes receivable increases. The entry in the illustration at the right shows the method of recording the transaction in the general journal.

October 11, 19...			
Notes Receivable.....	221 50		
M. D. Walters.....		221 50	
60-day draft accepted			
October 10.			

The increase in the asset notes receivable is recorded as a debit to the Notes Receivable account and the decrease in the asset accounts receivable, as a credit to the account with M. D. Walters.

REPORT

Complete Report No. 31 in the work book and present it for approval. Continue with the text discussion until Report No. 32 is required on page 118.

Trade Acceptance. A time draft drawn by the seller (drawer) at the time of a sale to a charge customer (drawee) is referred to as a *trade acceptance*. The purpose of the trade acceptance is to provide the seller with written evidence of the sale in negotiable form and at the time of the sale. The distinction between a time draft and a trade acceptance is that the time draft provides written evidence of a past due account while the trade acceptance provides written evidence of a sale at the time the sale is made. An accepted time draft and an accepted trade acceptance (each referred to as an *acceptance*) have the same meaning to the drawer as a note has to the payee, hence the acceptance and note are each regarded by the drawer or payee as a note receivable; each is regarded as a note payable by the drawee or the maker.

The time draft may be made payable a designated number of days after sight or date; a trade acceptance is always made payable a designated number of days after the date of the trade acceptance which is the date of the sale.

Illustration. The use of the trade acceptance is further explained by illustrations. May 10, Canton Bros., Buffalo, sold J. B. Martin, Jamestown, a charge customer, merchandise per sales invoice No. 99, \$378.65; terms, trade acceptance 60 days. The entry in the sales journal below is to record the sale.

SALES JOURNAL

May 19

Date	L.F.	Account Debited	Address	Terms	Sale No.	Amount
10		J. B. Martin	Jamestown	T. A. 60 days	99	378 65

You will observe that the entry to record this sale is the same as any other sale to a charge customer. The terms as stated are recorded in the sales journal and will be recorded in the explanation column of the account when posted.

A sales invoice is prepared in duplicate and the trade acceptance in the illustration below sent with the invoice to J. B. Martin.

TRADE ACCEPTANCE	
No. 21	BUFFALO May 10, 19
To J. B. Martin	Jamestown
On July 9	Pay to the order of Ourselves
(DATE OF MATURITY)	
Three hundred seventy-eight 65/100 Dollars, (\$ 378.65)	
The obligation of the acceptor hereof arises out of the purchase of goods from the drawer. The drawee may accept this bill payable at any bank, banker or trust company in the United States which he may designate.	
Accepted at	By Canton Bros.
Payable at	Bank
(SIGNATURE OF ACCEPTOR)	
By	W. B. Canton

\$378.65
 Due July 9, 19
 Date May 10, 19
 Favor of Canton Bros.
 Drawn on J. B. Martin
 Jamestown
 No. 21

Drawing a trade acceptance is not a transaction, hence no entry is made in a journal for the trade acceptance. The stub is retained, however, as a record of the trade acceptance.

When J. B. Martin receives the invoice and trade acceptance and honors it in accordance with the terms, he will return it to Canton Bros.; the accepted trade acceptance is in the illustration below.

TRADE ACCEPTANCE	
No. 21	BUFFALO May 10, 19
To J. B. Martin	Jamestown
On July 9	Pay to the order of Ourselves
(DATE OF MATURITY)	
Three hundred seventy-eight 65/100 Dollars, (\$ 378.65)	
The obligation of the acceptor hereof arises out of the purchase of goods from the drawer. The drawee may accept this bill payable at any bank, banker or trust company in the United States which he may designate.	
Accepted at Jamestown on May 14, 19	By Canton Bros.
Payable at First National	Bank
J. B. Martin	(SIGNATURE OF ACCEPTOR)
By	W. B. Canton

The receipt of an accepted trade acceptance from a charge customer in accordance with the terms of a sale is a transaction in which the asset notes receivable increases and the asset accounts receivable decreases. The general journal entry in the illustration at the right is to record the accepted trade acceptance illustrated on page 117.

May 15, 19...			
	Notes Receivable.....	378 65	
	J. B. Martin		378 65
	Trade acceptance No.		
	21.		

If desired, the face of each trade acceptance may be recorded in an account with the title *Trade Acceptances Receivable*. The usual plan, however, is to regard the accepted trade acceptance as a note receivable, hence record it in the Notes Receivable account.

Record of a Draft by the Drawee. To the drawer a sight draft is a means of collecting, hence no entry is made until cash is received for the draft. To the drawee a sight draft is a request which he may honor or dishonor as he desires. If he honors the sight draft, the check issued in payment is recorded in the same manner as if the check had been sent direct to the drawer; if he dishonors the draft, no entry is required.

When the drawee honors a time draft, he has promised in writing to pay a definite amount at a stated time, hence has assumed the same obligation as if he had issued a note to the drawer who is his creditor. For this reason, the drawee records an honored time draft in the same manner as a note payable, that is, he debits the account with the drawer and credits the Notes Payable account for the face of the time draft.

When the terms of a purchase are trade acceptance, the buyer will receive with the invoice a trade acceptance for acceptance. It is customary to record the invoice in the purchases journal as a debit to the Purchases account and a credit to the account with the creditor, and to record the trade acceptance when accepted in the general journal as a debit to the account with the creditor and a credit to the Notes Payable account. This requires an entry in two journals to record a transaction which is completed at the same time but it provides a more complete record of the transaction than recording it in the general journal only as a debit to the Purchases account and a credit to the account with Notes Payable.

REPORT

Complete Report No. 32 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 33 is required on page 122.

Collect on Delivery Sales. When merchandise is sold with the understanding that the customer is to pay for it when delivered, the terms are usually referred to as *C. O. D.*, that is *collect on delivery*. When delivery is to be made through the delivery service maintained by the seller, the agent of the seller, usually the truck driver, will collect for the merchandise when it is delivered. When delivery is made to an out-of-town customer by an express company or parcel post, the express agent or postman will collect before delivering the merchandise and the seller will receive a money order for the amount of the sale; it is customary for the buyer to pay the fee for issuing the money order. When the merchandise is shipped by freight, collection is made through a sight draft. The freight agent will hold the merchandise until the buyer presents the original copy of the *bill of lading*; the buyer can not secure the bill of lading until he has paid the sight draft.

Method of Making a C. O. D. Freight Shipment. When the terms of a sale are *C. O. D.* and the merchandise is to be shipped by freight, the seller follows the same process of recording the sale and making shipment as if the terms were on open account. When the merchandise is delivered to the freight agent, the bill of lading presented to him for signature is a form known as an *order bill of lading*, used only when the agent at destination is to hold the merchandise until the original bill of lading is presented by the one to whom the merchandise is shipped.

The order bill of lading is the same form as that illustrated on page 127 (*straight bill of lading*) except space is provided on the back for indorsement necessary in order to make collection. Three copies of the order bill of lading are presented to the freight agent and he signs two of them the same as for the straight bill of lading (page 127), retaining the third one for his record of the merchandise received.

The *consignee*, that is, the one to whom the merchandise is shipped, can not secure it until he presents the original bill of lading. In order that the collect on delivery terms may be made effective, the seller draws a sight draft for the amount of the sale payable to a bank in the city where the buyer does business and sends this draft together with the indorsed bill of lading to the bank at which it is payable. When the bank receives the draft and bill of lading, it notifies the consignee that he can secure the bill of lading by paying the draft. The consignee pays the draft, receives the original bill of lading, presents it to the freight agent and, upon paying the freight charges, receives the merchandise.

You will observe that when a sight draft is used to collect a past due account, it is only a request which the drawee can honor or dishonor because he already has possession of the merchandise. When a sight draft is used in connection with a *C. O. D.* freight shipment, the drawee has no choice; he must pay the draft if he wishes to obtain possession of the merchandise. Whether the sight draft is drawn for collection of a past due account or for the collection of

a C. O. D. sale, a bank is usually the payee. When possible, the draft should be drawn through the bank at which the drawee does business.

Illustrations. The use of a sight draft as a means of collecting a C. O. D. shipment is further explained by illustrations. These illustrations are applicable to a sale made by the Eureka Tire and Rubber Co., Cleveland, to R. W. Barton, Bellefontaine. The invoice mailed R. W. Barton in acknowledgment of the order is in the illustration below.

EUREKA TIRE & RUBBER COMPANY		DIRECTORS	
246 DEVONSHIRE STREET CLEVELAND, OHIO		H. BERT C. CARTER, TREAS. GEORGE W. CARTER, PRES. C. A. CARTER, V. PRES. F. V. CARTER, V. PRES. W. A. CARTER, V. PRES. E. A. CARTER, V. PRES. W. A. CARTER, V. PRES.	
No.		DATE AUGUST 14 19	
Sold to R. W. BARTON 119 MAIN ST. BELLEFONTAINE OHIO		YOUR ORDER A 3517 OUR ORDER 875 SALESMAN REID	
VIA C. C. C. & ST. L. R. R.		TERMS C. O. D.	
QUANTITY	DESCRIPTION	PRICE	AMOUNT
6	30 x 3 24" STANDARD CORDS	4.00	24.00
3	30 x 5 20" HEAVY DUTY CORDS	4.00	12.00
3	30 x 4.75 21" LOW PRESSURE BALLOONS	4.00	12.00
3	29 x 5.00 19" HEAVY DUTY BALLOONS	4.00	12.00
3	31 x 5.25 21" 4-PLY BALLOONS	4.00	12.00
3	32 x 6.75 23" 6-PLY BALLOONS	4.00	12.00
			312.60

The terms are C. O. D., shipment to be made by freight, hence an order bill of lading in triplicate is prepared; the original copy of this order bill of lading is illustrated on page 121.

When the original bill of lading is returned to the office signed by the freight agent, the draft in the illustration below is drawn by the Eureka Tire and Rubber Co., attached to the bill of lading and mailed to the collecting bank.

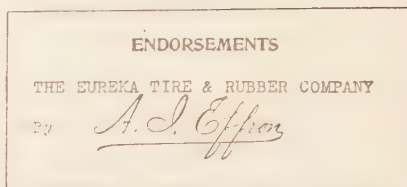

 Paid to CLEVELAND August 19 19

At sight Pay to the
 Order of Commercial Bank of Bellefontaine
 Three hundred twenty six Dollars

Value received and charge to account of
 To R. W. Barton } Eureka Tire & Rubber Co.
 No. 71 Bellefontaine } C. H. Talbot

indorsement. The form of indorsement, blank space for which is provided on the back of the bill of lading, is in the illustration at the right.

When the bank receives the draft and bill of lading, it will notify R. W. Barton that he can secure the bill of lading by paying the draft. If R. W. Barton pays the draft, the bank will give him the bill of lading and send remittance less its collection charges to the Eureka Tire and Rubber Co. The Eureka Tire and Rubber Co. will record the remittance received in the same manner as the collection of a sight draft.



Method of Recording C. O. D. Sales. The retail merchant who maintains his own delivery service will not record a C. O. D. sale until his driver collects the money; when the money is received from the driver, the sale is recorded as a cash sale. When the delivery is made by express, parcel post or freight, the sale is usually recorded as a debit to the account with the charge customer or to an account with the title *C. O. D. Shipments*. When collection has been made and the cash received from the collecting agent, the account which was debited at the time of the sale is credited for the amount of the sale; when a C. O. D. Shipment account is used, the collection is recorded on the credit side of the account on the same blue line as the amount of the sale is recorded on the debit side. Collection charges for C. O. D. shipments, unless paid by the buyer, are usually recorded by the seller in the same manner as collection charges for a note or draft, that is, as a debit to the Collection Expense account.

Method of Recording C. O. D. Purchases. When the terms of a purchase of merchandise are C. O. D., the buyer may, if he desires, record the check issued to pay for the merchandise when delivered (payment of sight draft at the bank) as a debit to the Purchases account. The usual plan, however, is to record the purchase in the purchases journal in the same manner as if the terms were open account and record the check in the cash book as a debit to the account with the creditor. If it is not desired to open an account in the ledger with a creditor from whom merchandise is purchased, terms C. O. D., and the transaction is recorded in the purchases journal and cash book, check marks may be placed in the folio columns on a line with the entries in the purchases journal and cash book to indicate that the credit from the purchases journal and the debit from the cash book are not to be posted.

REPORT

Complete Report No. 33 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 34 is required on page 131.

CHAPTER XI

TRADING ACCOUNTS

The purpose of accounting is to provide through account balances the information needed by the proprietor or management of a business and proof of the correctness of the records. The discussion in this chapter relates to the method of showing in separate accounts all of the needed information regarding the purchase and sale of merchandise.

Buying Merchandise. The merchant buys the merchandise which he sells. The wholesale merchant usually buys from the manufacturer, the retail merchant from the wholesale merchant and the consumer from the retail merchant. In some lines of merchandise the manufacturer sells direct to retail merchants or the consumer. Wholesale and retail merchants usually secure their merchandise through placing orders with traveling salesmen who submit samples or through ordering by mail. The consumer usually buys over the counter or by telephone.

The usual process of securing the merchandise offered for sale by the wholesale or retail merchant may be described as follows:

- (1) A written requisition for the needed merchandise issued by the *stock clerk*, the one authorized to keep the stock of merchandise.
- (2) The purchase order issued to the vendor by the *purchasing agent*, the one authorized to make purchases.
- (3) The purchase invoice prepared by the vendor and sent to the purchasing agent as an acknowledgment of the purchase order.
- (4) The delivery ticket, if the purchase is made from a local firm, or the bill of lading or way-bill issued by the transportation company, if purchased out-of-town.
- (5) The freight or express bill which is the bill for transportation charges when the merchandise purchased is not purchased from a local firm.
- (6) The drayage bill from the transfer company for the drayage cost of hauling from the freight station when the merchandise is shipped by freight.

Illustrations. The buying procedure is further explained by illustrations. These apply to a purchase of merchandise by J. A. Bryant from The Cole Tire Co., requisitioned by A. G. Parks, the stock clerk for J. A. Bryant, and ordered from The Cole Tire Co. by H. C. Fall, the purchasing agent for J. A. Bryant.

Requisition. It is customary in business for each clerk to provide a written record of all the transactions which he completes. The stock clerk has charge of the merchandise in stock. When merchandise is needed, it is the duty of the stock clerk to prepare written instructions regarding the needed merchandise and present it to the purchasing agent, that is, the one authorized to make the purchase. This written instruction is referred to as a *requisition*. A requisition is usually issued in duplicate, one copy for the stock clerk and one copy for the purchasing agent.

The illustration below is a requisition issued by A. G. Parks for the merchandise described therein. One copy is retained by A. G. Parks and the other given to H. C. Fall, the purchasing agent. This plan avoids any possible dispute in case the transaction is not completed as instructed in the requisition.

J. A. BRYANT CHICAGO		REQUISITION No. D-129
Purchase Requisition		
Required for Department <u>Stockroom</u>		Date Issued <u>Dec. 1, 19</u>
Advise Mr. <u>Doraey</u> on delivery		Date Required <u>Dec. 15, 19</u>
QUANTITY	DESCRIPTION	
12	29 x 4.75	19" Heavy Duty Balloon Tires
24	30 x 4.75	21" Low Pressure Balloon Tires
12	33 x 6.00	21" 6-ply Balloon Tires
12	31 x 5.25	21" 4-ply Balloon Tires
24	32 x 4	24" Heavy Duty Cord Tires
Approved by <u>J. A. Bryant</u>		Requisition Placed by <u>A. G. Parks</u>
Purchase Order No. <u>196</u>		Issued to <u>The Cole Tire Co.</u>
Date <u>Dec 1 19</u>		<u>T. J. J. J.</u>

The accountant will receive no notice of this requisition because it will not become a part of the accounting records until the merchandise has been purchased, hence no record is required in a journal for the requisition.

Purchase Order. When the purchasing agent receives from the stock clerk a requisition for the needed merchandise, he proceeds to order the merchandise from the firm which has been supplying it or from the firm which quotes the better price. The merchandise is ordered on a blank provided for this purpose and known as a *purchase order*. The purchase order is usually issued in triplicate, one copy mailed to the vendor (the one from whom the merchandise is purchased), one copy retained by the purchasing agent as his record of the purchase, and the third copy given to the stock clerk in acknowledgment of his requisition. The vendor knows from the order the needed merchandise to be shipped, the purchasing agent has a record of the merchandise with which to check the invoice when received and the stock clerk knows that his requisition has been honored.

The illustration below shows the purchase order prepared by H. C. Fall to secure the merchandise needed as indicated to him by the requisition. This purchase order contains full information to the vendor so that he may not only know the items of merchandise needed but the method of shipment and the terms of the purchase. The purchasing agent, of course, uses the terms and prices obtained from the vendor before the purchase order was prepared as the purchasing agent could not fix the prices and terms of the purchase. In other words, it may be assumed that H. C. Fall, the purchasing agent, has received a quotation from The Cole Tire Co. containing the prices and terms mentioned in the purchase order.

PURCHASE ORDER			No. <u>196</u>
J. A. BRYANT CHICAGO			
To <u>The Cole Tire Co.</u>		Date <u>December 1,</u> 19__	
<u>Buffalo</u>		Ship Via <u>Pa. R. R.</u>	
Deliver <u>by Dec. 15,</u> 19__		F. O. R. <u>Buffalo</u>	
		Terms <u>3/10 - n/30</u>	
QUANTITY	DESCRIPTION		PRICE
12	29 x 4.75	19" Heavy Duty Balloon Tires	15.30
24	30 x 4.75	21" Low Pressure Balloon Tires	9.95
12	33 x 6.00	21" 6-ply Balloon Tires	21.30
12	31 x 5.25	21" 4-ply Balloon Tires	15.25
24	32 x 4	24" Heavy Duty Cord Tires	16.70
<i>H. C. Fall</i>			

The preparation of a purchase order is not a transaction hence no record is required in a journal. It is only after the purchase has been made as evidenced by the invoice that a transaction has been completed which must be recorded.

Invoice. When the vendor receives a purchase order which to him is an *order*, he proceeds to fill it as requested. An invoice is prepared and mailed to the customer from whom the purchase order was received. This invoice is usually prepared in triplicate, one copy being retained for the accounting records of the vendor, one copy mailed to the customer for his records, and one copy referred to the shipping department in order that the merchandise mentioned in the invoice may be shipped to the customer.

The invoice is usually the only acknowledgment mailed to the customer. Sometimes, however, when a number of days will elapse before the merchandise can be shipped, an acknowledgment is mailed so that the customer may know that his purchase order has been received.

When the vendor does not have in stock all the merchandise required in a purchase order received from a customer, it is customary to ship all the available

merchandise and *back order* the remainder. A notation of this back order is made on the invoice so that the customer will know why his order was not filled as directed. The merchandise back ordered will be shipped when obtained unless the customer cancels this part of the order.

The illustration below is the purchase invoice prepared by The Cole Tire Co. and mailed to J. A. Bryant in acknowledgment of the purchase order prepared by H. C. Fall, the purchasing agent for J. A. Bryant a customer of The Cole Tire Co. The back order notation on the purchase invoice explains why all the items listed in the order do not appear on the purchase invoice.

THE COLE TIRE COMPANY

Wholesale Retail

BUFFALO

Invoice No 14251

Date Dec. 3, 19 Cust. Order No 196

Sold to J. A. Bryant
Chicago

Shipped to J. A. Bryant
Chicago

Shipped Via Pa. R. R. Terms: 3/10 - n/30

AMOUNT ORDERED	AMOUNT SHIPPED	DESCRIPTION	PRICE	PER	AMOUNT
12✓	12✓	29 x 4.75 19" Heavy Duty Balloon	15.30	✓ ea.	183.60✓
24✓	24✓	30 x 4.75 21" Low Pressure Balloon	9.95	✓ "	238.80✓
12✓	12✓	33 x 6.00 21" 6-ply Balloon	21.30	✓ "	255.60✓
12✓	12✓	31 x 5.25 21" 4-ply Balloon	15.25	✓ "	183.00✓
24✓	24✓	32 x 4 24" Heavy Duty Cord	16.70	✓ "	200.40✓
					1061.40.

12-31 x 4 Tired

This purchase invoice will be referred to the purchasing agent for verification of the units ordered and price after which it is sent to the accounting department to be recorded. As a result of this purchase the assets and liabilities of J. A. Bryant have each increased the amount of the invoice. This change in assets and liabilities may be either recorded in the purchases journal as illustrated below, or in a special column general journal as in Illustration 37, page 145.

PURCHASES JOURNAL

Date	L.F.	Account Credited	Address	Terms	Inv. Date	Amount
19 Dec. 5		The Cole Tire Co.	Buffalo	3/10-n/30	12/3	1061 40

Straight Bill of Lading. When a purchase order is received from an out-of-town customer, it is necessary to make delivery of the merchandise through a transportation company usually a railroad. When the merchandise is packed ready for shipment, it is delivered to the railroad for transportation to the customer. The agent for the railroad will issue a receipt for the merchan-

The illustration below is the *original copy* of the bill of lading received from the agent for the railroad by The Cole Tire Co. and mailed to J. A. Bryant with the invoice. The *shipping order* and *memorandum* are not illustrated because the purpose of the discussion here is to emphasize the business forms that will be received by the purchaser of merchandise. The information in each is the same since the three copies are prepared at the same time.

From the point of view of J. A. Bryant, the bill of lading is only evidence that the merchandise ordered has been shipped hence there is no transaction to record.

*The railroads in the United States are under the jurisdiction of the Interstate Commerce Commission. The Commission has set up certain regulations regarding the bills of lading. Three of these are (1) the size, (2) the number of copies to be prepared and (3) the color of the paper on which the copies are to be printed. The size of the bill of lading and color of the paper to be used are regulated for the convenience of the buyer, the seller and the transportation company.

The illustration below is the freight bill received by J. A. Bryant when the merchandise mentioned in the requisition on page 124 and in the order on page 125 was delivered to him by his freight agent. It shows the amount of the freight paid.



Make checks payable to

THE PENNSYLVANIA RAILROAD COMPANY

Dr. For Charges on Articles Transported:

SECTION

DATE **December 10, 19**

CONSIGNEE **29 X**

DESTINATION **J. A. Bryant, Chicago**

FREIGHT BILL

CHICAGO

FRONT AND BUTLER STS.

A. D. 1925-A
26m 8435w 1-6-28

FREIGHT BILL
No. **385745**

Point of Origin or Destination

Way-Bill From
Buffalo
Point and Date of Shipment

Way-Bill Date and No.
1829 Dec. 3
Connecting Line Reference

Full Name of Shipper
The Cole Tire Co.
Previous Way-Bill Reference

Car Initials and No.
C 29475
Original Car Initials and No.

NUMBER OF PACKAGES, ARTICLES AND MARKS	WEIGHT	RATE	FREIGHT	ADVANCED	TOTAL
36 Bundles, 72 Tires	1662#	1.40	23.27		23.27
TOTAL PREPAID:					
RECEIVED PAYMENT					

Original paid freight bills must be surrendered for overcharges to be refunded and must accompany claims for overcharge, loss or damage.

192

TOTAL

23.27

FREIGHT AGENT

J. A. Bryant

The freight is usually paid by check, hence the entry to record it on the payments side of the cash book is from the check stub. The freight bill as well as the original bill of lading should be retained by the consignee because very often errors are made in the freight rate or extensions and both these forms must be submitted if any correction is to be made.

The entry in the cash book of J. A. Bryant to record the freight paid is shown in the first entry in the cash book on page 129.

You will observe that the title of the account debited is Freight and Drayage In. As explained at the beginning of this chapter, the merchant needs to know the transportation cost separate from the invoice cost. Recording the invoice cost in the purchases journal as a debit to the Purchases account and recording the freight cost in the cash book as a debit to the Freight and Drayage In account provides the desired information in two accounts.

When taking stock the freight on each unit of merchandise may be added to the invoice cost, or the estimated amount applicable to the merchandise in stock may be shown in one amount at the conclusion of the inventory.

Drayage Cost. It will be necessary for the buyer to haul the merchandise from the freight station to his store because the railroad company makes delivery only to its freight station. The cost of hauling the goods from the freight station to the store is referred to as drayage. This cost may be the result of paying a drayage company a fixed amount for hauling the merchandise or the expense incident to maintaining delivery equipment. In either case, the amount

paid for drayage on merchandise purchased is recorded as a debit to the Freight and Drayage In account. Separate accounts may be maintained with freight and with drayage but the usual plan is to combine the two into one account because they both have the same meaning.

The word "In" is used in the title of the account to designate that this is the freight and drayage on merchandise purchased and has no relation to the cost of delivering merchandise sold to customers or to the freight station for delivery to him.

CITY TRANSFER CO

EXPRESS AND DRAYAGE

OFFICE

114 WEST SECOND STREET

CHICAGO

PHONE

MAIN 1236 - 1237

Date

December 10, 19..

To

J. A. Bryant

542 S. Dearborn

City

Drayage on Cole Tire Co. shipment, December 3

\$ 1.75

The second entry in the illustration below shows the cash book entry to record the check issued by J. A. Bryant to pay the drayage company for hauling the merchandise from the freight station to his store.

CASH				Payments		
Date	L.F.	Account Debited	Explanation	Amount Dr.	Pur. Dis. Cr.	Net Cash Cr.
Dec. 10		Freight & Dray. In.	Freight on 12 15 Pur.	23 27		23 27
10		Freight & Dray. In.	Drayage on 12/15 Pur.	1 75		1 75

Purchases Returns and Allowances. The buyer expects to receive the merchandise ordered and to pay for it at the agreed price and in accordance with the agreed terms. If a part or all of the merchandise delivered as a result of the purchase order is not satisfactory and for this reason is returned, it is referred to by the buyer as a *purchase return*. If the merchandise received is not satisfactory or if the price is not that agreed upon, the seller may be required to adjust the price to the satisfaction of the buyer; an adjustment of this character is referred to by the buyer as a *purchase allowance*.

When the seller receives from his customer a part of the merchandise which was sold to him or when the seller makes an allowance to his customer because of unsatisfactory goods, written evidence is submitted by the seller to his customer on a written form referred to as a *credit memorandum*. In other words, a credit memorandum is written information received by the buyer from the seller regarding a purchase return or a purchase allowance. The credit memorandum is usually prepared in duplicate, one copy sent to the customer and the other retained by the seller.

The illustration below is a credit memorandum rendered by the Cole Tire Co. to J. A. Bryant to adjust an error resulting from one item of merchandise not being the same as that ordered and described on the invoice. This merchandise was returned by express collect because the error was made by the Cole Tire Co.

CREDIT MEMORANDUM

THE COLE TIRE CO.
All Leading Makes of Tires
BUFFALO

DATE December 21, 19
TO J. A. Bryant
542 So. Dearborn
Chicago

CREDIT YOUR ACCOUNT AS FOLLOWS

2	31 x 5.25	21" 4-ply Balloon Tires	@ 15.25	\$ 30.50
---	-----------	-------------------------	---------	----------

A return of a part of the merchandise results in a decrease in the purchases and a decrease in the liabilities. For this reason the credit memorandum is a business paper which will be referred to the accountant so that he may record the changes. The entry in the illustration at the right shows the entry in the general journal of J. A. Bryant to record the information shown by the credit memorandum received from the Cole Tire Co. You will observe

24				
The Cole Tire Co.....		30	50	
Pur. Ret. and Allow. ..				30 50
Two 31x5.25 tires re-				
turned.				

that an account with the title *Purchases Returns and Allowances* is credited to record the decrease in purchases. This credit could have been made direct in the Purchases account but it is desired to know the amount of the merchandise returned in order to measure the efficiency of those from whom the business buys. Allowances is included in the title of the account because it is to contain a record of allowances made by the seller as well as the cost of merchandise returned. If desired, separate accounts may be maintained with *Purchases Returns* and with *Purchases Allowances*; this would be required only when it is necessary to know these two items in separate amounts.

Accounts Required for Recording Purchases. You will observe from the foregoing discussion and illustrations that at least three accounts are usually required to record all the facts regarding merchandise purchased for sale.

In addition to the three accounts discussed, the Merchandise Inventory account will be required at the close of each fiscal period, hence will appear on the ledger at the beginning of the second fiscal period and each period thereafter.

Merchandise Inventory Account. The purpose of this account is to contain a record of the asset value of the merchandise in stock at the beginning of each fiscal period. It is *debited* at the close of each fiscal period for the value of the merchandise in stock as shown by the merchandise inventory and *credited* at the close of each fiscal period for the merchandise in stock at the beginning of the fiscal period.

This account is usually not debited and credited during the fiscal period. At the beginning of the fiscal period the *debit* balance is the asset value of the merchandise on hand; during the fiscal period it has the same meaning as the debit balance of the Purchases account.

Some accountants transfer the merchandise inventory at the beginning of the fiscal period to the Purchases account in which case the Merchandise Inventory account is in balance during the period. The better plan is to make this transfer entry at the close of the fiscal period so that during the period the balance of the Purchases account will show the cost of merchandise purchased during the current period.

The Purchases Account is a record of the merchandise purchased for sale. This account is *debited* for the invoice cost of the merchandise purchased, and *credited* for errors in extensions on purchase invoices or the failure to receive merchandise billed. The *debit* balance at the close of the fiscal period shows the invoice cost of the merchandise purchased during the period; it is closed into the Trading account.

The Freight and Drayage In Account is a record of the transportation cost of merchandise purchased. It is *debited* for freight, express, postage, and drayage cost, and *credited* for decreases which are adjustments which reduce the transportation cost. The *debit* balance at the close of the fiscal period shows the transportation cost of the merchandise purchased during the period; it is closed into the Trading account.

The Purchases Returns and Allowances Account is a record of allowances made by creditors because of merchandise returned, unsatisfactory goods or incorrect price. It is *credited* for the amount of each allowance or return, usually represented to the accountant by a credit memorandum received from the creditor; this account is usually not debited. The *credit* balance at the close of the fiscal period shows the total allowances made by creditors during the period; it is closed into the Trading account.

REPORTS

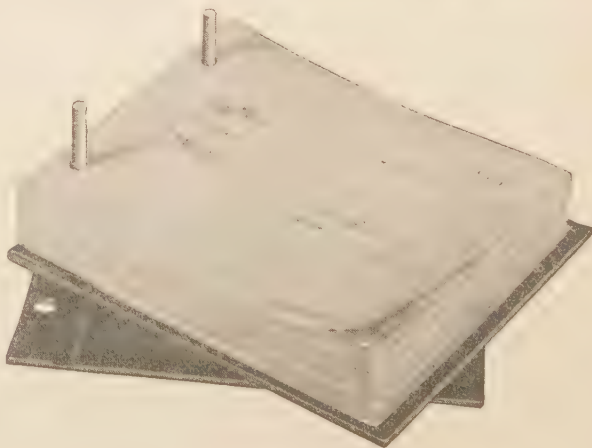
Complete Report No. 34 in the work book and present to the instructor for approval. While waiting for it to be approved, proceed with the text discussion until Report No. 35 is required on page 135.

Sales of Merchandise. The purchase order issued by the buyer becomes an order when received by the seller. The invoice received by the buyer is also referred to as an invoice by the seller; sometimes the two are distinguished through referring to one as a purchase invoice and the other as a sales invoice. The original copy of the credit memorandum issued by the seller and received by the buyer is to the buyer a *purchase return* or *purchase allowance* and to the seller a *sales return* or a *sales allowance*. The original copy of the bill of lading received by the buyer is his authority to secure the merchandise from the railroad and the memorandum copy retained by the seller is his receipt from the railroad for the merchandise.

Illustration. The selling procedure is further explained by illustrations. These illustrations relate to a sale made by J. A. Bryant to one of his customers. The accountant for J. A. Bryant would follow the plan outlined on pages 123-131 for recording a purchase, and that which follows for recording sales.

Recording Charge Sales. Information regarding a charge sale is reported to the accountant through a copy of the sales invoice rendered the charge customer. This copy is usually made by the use of carbon paper so that the original and copy will each contain the same information. The sales invoices are numbered consecutively to avoid the possibility of failure to record a sale; each original and each copy has the same number. The copies are usually punched to fit a binder, arranged numerically and filed in the binder in the accounting department.

The illustration at the right shows the form of a binder which has several hundred sales invoices filed in it. The top invoice shows the facts regarding sale No. 504. Each sheet in this binder represents to the accountant for J. A. Bryant a transaction in which the asset accounts receivable increases and the sales increase the amount of the sale. The increase in assets is recorded as a debit to the account with the charge customer and the Sales account is credited at the end of the month or when a Trial Balance is to be taken for the total of all the sales made during the month.



It is customary at the time the sales are posted to list the amount of each sale on the adding machine and to place this list on top of the last sale

recorded in the sales journal, that is, the last sales invoice copy for the month. A recapitulation of the sales showing the number and name of the charge customer is not usually prepared unless it is desired to separate the sales by departments or it is necessary to separate prepaid transportation charges from the sales. It is quite evident that care must be used in listing the sales on the adding machine because an error in the total would affect the total sales and consequently the Trial Balance.

Cash Sales. In a retail business where many cash sales are made each day, it is customary to record each sale in the cash register and record the total on the receipts side of the cash book at the end of the day as a credit to the Sales account. In a wholesale business where only a few cash sales are made and an invoice is prepared for each sale, it is customary to file all the copies of sales in the sales binder. This means that the cash customer will be debited for the amount of the sale to him, hence he must be credited in the cash book for the amount of the cash received.

Sales Returns and Allowances. When a charge customer is allowed to return part or all of the merchandise sold, a credit memorandum is issued to him when the merchandise is received for the value of the merchandise at the selling price. When the price or the goods is not satisfactory and an allowance is made, a credit memorandum is rendered for the amount of the allowance at the time it is granted. The credit memorandum is made in duplicate, one copy mailed to the customer and the other given to the accounting department. It is necessary for the accounting department to have this copy because the asset accounts receivable and the sales decrease.

The illustration at the right is to record the facts stated in a credit memorandum rendered by J. A. Bryant to the charge customer named. This entry is made from a copy of the credit memorandum as the original was mailed to the charge customer. The

Sales Returns and Allowances account is debited to record the decrease in sales and the account with Service Tire Shop credited

	20		
Sales Returns and Allow.		13 50	
Service Tire Shop			13 50
Credit memorandum			
No. 24.			

to record the decrease in the asset accounts receivable. The copy of the credit memorandum is filed in the correspondence with the Service Tire Shop. The "No. 24" in the explanation is the number of the credit memorandum, these being numbered consecutively in the same manner as the sales invoices.

The debit to the Sales Returns and Allowances account could be made to the Sales account. Since the merchant usually likes to know the total amount of the merchandise returned by customers in order to measure the efficiency of his clerks and the quality of the goods he sells, it is customary to record the amount of each return or allowance to a charge customer in an account separate from sales. Sales Returns and Allowances is a descriptive title which has a

definite meaning. If desired, the amount of each returned sale may be recorded in an account with the title *Sales Returns* and the amount of each allowance in an account with the title *Sales Allowances*; the two accounts would be required only when there are many credits because of returns and allowances.

Freight Out. The merchant usually delivers the merchandise sold to local customers and delivers to his freight station the merchandise sold to out-of-town customers. Under these conditions, the amount of freight prepaid on merchandise sold to a charge customer is debited to the account with the customer; this includes postage on parcel post shipments and prepaid express on express shipments.

The expression "f. o. b. our freight station" is usually used when a customer requests a price on the merchandise he expects to buy. Thus, if the merchant who is requested to make a price is located in Chicago, he will state in connection with the price quoted "f. o. b. Chicago." The customer knows from this information that he is to pay the freight from Chicago to his freight station.

The letters "f. o. b." are the first letters in the words "free on board" and as stated mean delivered to the freight station ready for placing on board the cars for shipment.

Some merchants and manufacturers quote a delivered price on the merchandise they offer for sale. Under these conditions, the expression "f. o. b. your freight station" is used in connection with the prices quoted. Thus, if a merchant requesting a price on the merchandise he expects to purchase is located in Omaha, the prices quoted will be "f. o. b. Omaha." He knows from this information that the freight will be paid to Omaha, that is, the merchandise will be delivered to the Omaha freight agent or credit will be allowed for the freight if the freight is not prepaid.

When the merchant or manufacturer quotes a price f. o. b. the customer's freight station, he will issue a check in payment of the freight when the merchandise is delivered to his freight agent. The amount of this check is debited to an account with the title *Freight Out*. The balance of the Freight Out account which will show the total payments for freight on merchandise sold is regarded as a deduction from the sales because it is assumed that the selling price is sufficient to include the prepaid freight in addition to the usual cost and expenses that are to come out of sales. The Freight Out account is an unusual account because of the custom of selling "f. o. b. point of sale" and not "f. o. b. point of delivery." It is mentioned here, however, in order that you may understand that it will be required where the seller agrees to deliver merchandise to an out-of-town customer. Some accountants regard freight out as a deduction from the sales while others regard it as an increase in the selling cost; the former is considered the better practice.

The purpose of the foregoing discussion is to explain the distinction between freight *in* and freight *out* and the necessity for two accounts, also to call your attention to the fact that the balance of the Freight In account is a part of the cost price of the merchandise purchased and the balance of the Freight Out account is a deduction from the total sales.

Accounts Required for Recording Sales. You will observe from the foregoing discussion and illustrations that at least two accounts are usually required to record all the facts regarding sales the Sales account and the Sales Returns and Allowances account. If desired, sales returns may be recorded in one account and the sales allowances in another account, thus requiring three accounts for recording sales. The Freight Out account will be required only when merchandise is sold f. o. b. the freight station of an out-of-town charge customer.

The Sales Account is a record of the income from sales. It is *credited* for cash and charge sales and *debited* for errors which reduce the credit balance. The *credit* balance at the close of a fiscal period shows the sales for the period; it is closed into the Trading account.

Errors which reduce the credit balance of the Sales account usually result from errors in extensions on invoices or the failure to ship merchandise billed.

The Sales Returns and Allowances Account is a record of the allowances made to customers because of merchandise returned by them, unsatisfactory goods, or incorrect prices. It is *debited* for credits allowed to customers; this account is usually not credited. The *debit* balance at the close of a fiscal period shows the total allowances made to customers during the period; it is closed into the Trading account.

If desired, separate accounts may be maintained with Sales Returns and Sales Allowances; the former would contain a record of the returns and the latter, the allowances.

The Freight Out Account is a record of all prepaid transportation charges. It is *debited* for the transportation cost at the time it is paid, and *credited* for that part of the prepaid transportation to be charged to charge customers. The *debit* balance shows the transportation cost because of terms f. o. b. point of delivery; it is closed into the Trading account.

Some accountants record all selling expenses as a part of the trading or selling cost and include with the trading accounts those accounts which contain a record of selling costs. The plan discussed in this chapter, that is, including as trading accounts only those accounts which contain the information needed for ascertaining gross profit on sales, is regarded as the better practice. The usual selling expenses are discussed in a subsequent chapter.

REPORTS

Complete Report No. 35 in the work book and present to the instructor for approval. While waiting for it to be approved, proceed with the text discussion until Report No. 36 is required on page 139.

Trading Accounts. A mercantile business is often referred to as a trading business and the accounts needed to record the purchases cost and selling price of merchandise as *trading* or *selling* accounts. The trading accounts discussed in this chapter are Merchandise Inventory, Purchases, Freight and Drayage In, Purchases Returns and Allowances, Sales, and Sales Returns and Allowances. As explained, an account with Freight Out will be required if the firm delivers the merchandise to out-of-town customers but this account is usually not required. In other words, the usual trading accounts are those with

Merchandise Inventory, Purchases, Freight and Drayage In, Purchases Returns and Allowances, Sales, and Sales Returns and Allowances.

Trading Statement. It is customary at the close of the fiscal period to show the gross profit on sales through a statement referred to as the *Trading Statement*. This may be a separate report or the first part of the Profit and Loss Statement.

The accounts in the illustration at the right appear on the ledger of J. A. Bryant, an automobile tire merchant, at the close of the December monthly fiscal period. The Merchandise Inventory account shows the asset value of the merchandise in stock December 1; it was an asset but December 31 it may all have been sold. The balance of the Sales account shows the total sales for December; a debit amount would have indicated errors in extensions, shipping merchandise, etc. The balance of the Sales Returns and Allowances account shows the amount of Sales Returns and Allowances for the month; the record in this account includes only the value of merchandise returned by charge customers or allowances made to them. The debit side of the Purchases account shows the total purchases during December, and the credit side, the tires taken out of stock at cost price by J. A. Bryant; the balance is the net amount of merchandise placed in stock for sale. The debit balance of the Freight and Drayage In account shows the total amount paid as transportation charges during the month of December; this adds to the cost of merchandise bought. The debit balance of the Purchases Returns and Allowances account shows the cost price of merchandise returned to creditors or allowances made by them. The merchandise inventory, December 31, is \$5,896.13; a part of this merchandise may be that included in the December 1 inventory and a part of it recorded as a debit to Purchases.

MERCHANDISE INVENTORY

19				
Dec.	1			5628 40

SALES

19				
Dec.	19			78 50
	31			5171 10
				5249 60

SALES RETURNS AND ALLOWANCES

19				
Dec.	20			13 50
	29			8 50
	30			2 50
				24 50

PURCHASES

19				
Dec.	31	4185.15	4263 75	
19				
Dec.	12			78 60

FREIGHT AND DRAYAGE IN

19				
Dec.	16			56 35
	27			29 35
	31			62 38
				148 08

PURCHASES RETURNS AND ALLOWANCES

19				
Dec.	22			15 50
	24			30 50
				46 —

The illustration below is a Trading Statement prepared from the accounts on page 136 and the December 31 merchandise inventory. The purpose of this statement is to ascertain the gross profit on sales, that is, the amount of profit made by selling merchandise; it does not include the cost of selling. Information in regard to other income and the expenses is shown on the Profit and Loss Statement. The Trading Statement may be combined with the Profit and Loss Statement in one report, with the Trading Statement first, or they may be prepared as two separate reports.

J. A. BRYANT

TRADING STATEMENT, December 31, 19...

Income from Sales:		
Gross Sales	5249 60	
Less Sales Returns and Allowances	24 50	
Net Returns from Sales		5225 10
Cost of Merchandise Sold:		
Purchases	4185 15	
Add Freight and Drayage In	148 08	4333 23
Less Purchases Returns and Allowances	46 —	
Net Cost of Merchandise Purchased	4287 23	
Add Merchandise Inventory December 1	5628 40	
Net Cost of Merchandise Available for Sale	9915 63	
Less Merchandise Inventory December 31	5896 13	
Net Cost of Goods-Sold		4019 50
Gross Profit on Sales		1205 60

Turnover refers to the number of times merchandise is sold during a year. Thus, if merchandise remains in stock for a full year before it is sold, the turnover is only one, but if the goods can be sold in three months, additional merchandise may be purchased and made available for sale, thus giving a turnover of four. It is quite evident that the greater the turnover the less will be the profit required on each sale in order to produce a satisfactory rate of profit on the investment.

The number of times the stock is turned over, or the rate of turnover, may be found by dividing the cost of sales by the average inventory. The average inventory is the quotient found by dividing the sum of the beginning and ending inventory by two. Thus, if the beginning inventory is \$9,000.00 and the ending inventory, \$6,000.00, the average inventory is \$7,500.00. If the cost of the goods sold during the year is \$15,000.00, the turnover is two, that is, the merchandise is turned over twice during the year.

Annual turnover cannot be ascertained from the Trading Statement illustrated because the figures shown are for one month.

Closing the Trading Accounts. As explained in Chapter VI, it is customary to close the ledger at the end of each fiscal period. When the trading accounts discussed in this chapter are maintained, the balance of each account

is closed into a summary account with the title *Trading*. In other words, the trading accounts are summarized in the Trading account.

The entries in the illustration at the right show the method of summarizing the trading accounts in the Trading account. The purpose of these entries is the same as the first, second, fourth and fifth entries in the closing entries on page 76. The beginning merchandise inventory and the closing merchandise inventory are, however, transferred to the Trading account instead of being transferred to the Purchases account; the results are the same in either case.

Three entries are usually required to summarize the trading accounts. The first entry in the illustration transfers all trading accounts with a debit balance to the debit side of the Trading account, the second entry records the December 31 merchandise inventory and transfers all trading accounts with a credit balance to the credit side of the Trading account, and the third entry transfers the credit balance of the Trading account to the Profit and Loss Summary account.

The accounts in the illustration at the right and on page 139 show the results of posting the journal entries in the preceding illustration to the accounts on page 136 with the Trading account as it appears after the other accounts are closed. You will observe that the Merchandise Inventory account now shows the ending inventory and the other accounts are closed. The gross profit on sales is shown on the credit side of the Profit and Loss Summary account. The

December 31, 19...			
Trading.....	9986	13	
Merchandise Inventory.....			5628 40
Sales Ret. and Allow....			24 50
Purchases.....			4185 15
Freight and Drayage In.....			148 08
To close accounts with debit balances into the Trading account.			
31			
Merchandise Inventory....	5896	13	
Sales.....	5249	60	
Purchases Ret. and Allow.	46	—	
Trading.....			11191 73
To close accounts with credit balances into the Trading account.			
31			
Trading.....	1205	60	
Profit and Loss Summary.....			1205 60
To close balance of Trading account into Profit and Loss Summary account.			

MERCHANDISE INVENTORY			
19 Dec. 1	5628 40	19 Dec. 31	5628 40
31	5896 13		
SALES			
19 Dec. 31	5249 60	19 Dec. 31	78 50
			5171 10
	5249 60		5249 60
SALES RETURNS AND ALLOWANCES			
19 Dec. 20	13 50	19 Dec. 31	24 50
29	8 50		
30	2 50		
	24 50		24 50

PURCHASES			
19		19	
Dec.	31	Dec.	31
	4263 75		78 60
			4185 15
	4263 75		4263 75

FREIGHT AND DRAYAGE IN			
19		19	
Dec. 16	56 35	Dec. 31	148 08
27	29 35		
31	62 38		
	148 08		148 08

PURCHASES				RETURNS AND ALLOWANCES			
19				19			
Dec.	31		46	Dec.	22		15 50
					24		30 50
			46				46

PROFIT AND LOSS SUMMARY

19	
Dec. 31 Trading	1205 60

19				19			
Dec.				Mar.			
31	Mdse. Inv.	Dec. 1	5628 40	31	Mdse. Inv.	Dec. 31	5896 13
31	Sales R. and A.		24 50	31	Sales		5249 60
31	Purchases		4185 15	31	Pur. R. and A.		46 —
31	Frt. and Dray. In.		148 08				
31	P. and L. Sum.		1205 60				
			11191 73				11191 73

The Trading account may be made a section of the Profit and Loss Summary account in which case the title of the account is Trading, Profit and Loss Summary. The credit balance of the trading section of the Trading, Profit and Loss Summary account is carried down below ruled lines before summarizing the other income and the expense accounts.

Complete Report No. 36 and present for approval, then complete Report No. 37. While you are waiting for Report No. 37 to be approved, proceed with the text discussion until Report No. 38 is required on page 143.

CHAPTER XII

CASH DISCOUNT AND COLUMNAR JOURNALS

When merchandise is sold on credit, the buyer usually has thirty, sixty or ninety days in which to make payment. In order to encourage him to make payment before the time allowed, the seller may grant him a cash discount (accept a check for less than the amount of the purchase) for payment within a shorter time. The discussion in this chapter relates to (a) the method of recording transactions in which cash discount is involved, (b) a columnar cash book for cash discount, and (c) the columnar sales journal and general journal.

Cash Discount. The amount deducted from an invoice because of an agreement (by a creditor or with a customer) made at the time of a purchase or sale is referred to as *cash discount*. The purpose of the agreement in which cash discount is involved is to facilitate collection. The buyer will make a greater effort to pay an obligation promptly if by so doing he is allowed to cancel it with a less amount of cash than the obligation.

Terms on Invoices. The agreement regarding cash discount is explained in the terms of the invoice. Thus, the terms "2 10 n 60" on a purchase is an agreement with the seller to accept 98% of the amount of the invoice in full payment if the 98% is received within 10 days from the date of the invoice; if the amount is not received within ten days, the purchaser is required to pay the full amount of the invoice, that is 100% of it at the expiration of the sixty days. When the terms are "60 days", the purchaser may pay the amount of the invoice at any time within sixty days from the date of the invoice but he will have to pay the full amount of the invoice. The terms always apply to the date of the invoice and never to the date the invoice or merchandise is received by the purchaser.

Cash discount applies to both the buyer and the seller. The buyer refers to it as a *purchases discount*; the seller, as a *sales discount*. The cash discount on an invoice of \$500.00 with terms "2 10 n 30" is 2% of \$500.00 or \$10.00. If the invoice is rendered by R. H. McDonald to C. L. Tweed, the \$10.00 is a purchases discount to C. L. Tweed and a sales discount to R. H. McDonald.

Purchases Discount. As explained, this term is applied by the purchaser to the cash discount which he obtains through payment of his invoices within the discount period. Each purchase of merchandise on credit involves a minimum of two transactions, (1) the purchase, and (2) the payment.

Each purchase of merchandise is an increase in the asset merchandise and an increase in the liabilities for the amount of the purchase. The transaction is recorded either in the general journal or the purchases journal so that the increase in assets and the increase in liabilities may be recorded in the ap-

propriate accounts in the ledger through posting. The change in assets and liabilities because of the purchase on credit is not affected by a cash discount agreement, hence each purchase is recorded in the same manner whether or not cash discount is involved.

It is, however, necessary to record the terms both in the journal and ledger. The terms involve four elements of information (a) the date of the invoice, (b) the rate per cent of the cash discount, (c) the time limit for the cash discount, and (d) the time limit for paying the full amount of the invoice. Recording in the explanation column of the ledger "May 5, 2 10 n 30" provides in the account all the required information regarding the terms.

When a check is sent in payment for the full amount of an invoice, the transaction results in a change in the assets and liabilities, a decrease in the asset cash, and a decrease in liabilities for the amount of the check. When cash discount is involved, the amount of the check required to pay an invoice will be less than the amount of the invoice; the difference between the amount of the check and the amount of the invoice is an increase in proprietorship because a liability is canceled with a less amount of assets than the amount of the liability.

The general journal entry at the left and the cash book entry below record a check issued in payment of an invoice less discount. The amount of the invoice is \$560.00; the terms, "November 3, 3/10 n, 60." The check was issued November 11 to provide time for it to reach the creditor within the

November 11, 19....			
	J. B. Menz.....	560 —	
✓	Cash.....		543 20
	Purchases Discount....		16 80
	Paid invoice of 11/3 less 3% discount.		

discount period. The entire amount of the obligation, \$560.00, is canceled, hence the account with the creditor is debited for this amount; the asset cash decreases the amount

of the check, hence the Cash account is credited for \$543.20; the proprietorship increases the difference between the amount of the check and the amount of the invoice, hence an account with the descriptive title *Purchases Discount* is credited. The entry in the cash book is necessary because all cash transactions are recorded in this book. The check marks in the folio columns of the general journal and cash book are to avoid double posting.

CASH				Payments
19	Nov. 11	✓ J. B. Menz	In full of account less 3%	543 20

When the journal entry is posted, the account with J. B. Menz is in balance and the Purchases Discount account is credited with \$16.80, the increase in proprietorship. The decrease in the asset cash will be recorded in the ledger when the total of the cash book is posted at the end of the month.

A transaction in which purchases discount is involved may be recorded in the cash book only as illustrated at the top of page 142.

CASH					Payments	
Date	L.F.	Name of Account	Explanation	Amount Dr.	Pur. Disct. Cr.	Net Cash Cr.
19 Nov.	11	J. B. Menz	Invoice 11 '3, less 3%	560 —	16 80	543 20

Three amount columns are provided: (1) the amount of the invoice, (2) the amount of the discount, and (3) the net cash paid. When posting, the creditor is debited with the amount of the invoice because this is the amount of the liability canceled. Placing the purchases discount in a column will permit ascertaining the total purchases discount through addition, hence it will not be necessary to post the amount of each discount as the total can be posted at the end of the month. Placing each amount of cash paid in a column permits ascertaining the total cash paid through addition, hence the total can be posted at the end of the month.

If an extra column is not provided in the cash book the full amount of the invoice may be recorded on the payments side in the column with the other amounts paid and the amount of the discount recorded on the receipts side in the column with the other amounts received. This has the same effect but it does not permit the receipts side of the cash book to show the total receipts nor the payments side to show the total payments, neither does it permit recording the amount of the check. For the reasons stated, this plan is not satisfactory, hence is not illustrated.

Sales Discount. As explained, sales discount is the cash discount allowed a customer for collection from him within a specified time. Each sale of merchandise on credit involves a minimum of two transactions, (1) the sale, and (2) the collection.

Each sale of merchandise is an increase in the asset accounts receivable and an increase in the sales. The transaction is usually recorded in the sales journal so that the increase in the asset and the increase in sales may be recorded in the appropriate accounts in the ledger through posting. The change in assets and sales because of a sale on credit is not affected by a cash discount agreement, hence each sale is recorded in the same manner whether or not cash discount is involved.

It is, however, necessary to record the terms both in the journal and ledger. The terms involve three elements of information (a) the rate per cent of the cash discount, (b) the time limit for the deduction of the cash discount, and (c) the time limit for collecting the full amount of the invoice. Recording in the date column of the ledger "August 11" and in the explanation column "2 30 n 60" provides in the account all the information required in regard to the terms.

When a check is received from a charge customer for the amount of his indebtedness, the transaction results in an increase in the asset cash and a decrease in the asset accounts receivable for the amount of the check. When cash discount is involved, the check received from the charge customer will be less than the amount of the sale; the difference between the amount of the check

and the amount of the sale is a decrease in proprietorship because the amount of the asset canceled is less than the amount of assets received.

The general journal entry at the left and the cash book entry below record a check for \$470.40 received September 10 from O. D. Julian, a charge customer,

September 10, 19.....			
✓	Cash.....	470 40	
	Sales Discount.....	9 60	
	O. D. Julian.....		480
	Received cash for sale of August 11 less 2% discount.		

for a sale of \$480.00 less 2% discount, \$9.60. The asset cash increases \$470.40, the asset accounts receivable (O. D. Julian) decreases \$480.00, and the proprietorship de-

creases \$9.60, hence the Cash and Sales Discount accounts are debited and the account with the charge customer is credited. The check marks in the folio columns are to avoid double posting.

CASH				Receipts	
19	Sept. 10	✓ O. D. Julian	Invoice 8 11, less 2%	470 40	

When the journal entry is posted, the account with O. D. Julian is in balance and the Sales Discount account is debited with \$9.60, the decrease in proprietorship. The increase in the asset cash will be recorded in the ledger when the total of the cash book is posted at the end of the month.

A transaction in which sales discount is involved may be recorded in the cash book only as illustrated below.

CASH				Receipts		
Date	L.F.	Name of Account	Explanation	Amount Cr.	Sales Disc. Dr.	Net Cash Dr.
19 Sept. 10		O. D. Julian	Invoice 8/11, less 2%	480 —	9 60	470 40

Three amount columns are provided (1) the amount of the invoice, (2) the amount of the discount, and (3) the amount of cash received; each transaction is recorded on one line with the amounts in the appropriate columns. When posting, the customer is credited with the amount of his invoice; the amount in the Sales Discount column and the amount in the Net Cash column are not posted until at the end of the month at which time the total of each column is posted.

If an extra column is not provided in the cash book, the full amount of the invoice may be recorded on the receipts side and the amount of the discount on the payments side. As explained on page 142, this plan is not satisfactory, hence not illustrated.

REPORTS

Complete Report No. 38 in the work book and present it for approval. While waiting for it to be approved, proceed with the text discussion until Report No. 39 is required on page 154.

Columnar Journals. If a transaction is to be recorded and posted quickly, it must be recorded in one journal only. This efficient method of recording transactions can be applied only through the use of columnar journals. The term *special columns* is also used to describe columnar journals.

The nature of the transactions to be recorded will determine the journals and the columns to be provided in each. The discussion which follows relates to the use of special columns in the purchases journal, sales journal and cash book. Do not interpret these illustrations as containing the only special columns to be used in journals of this type; they are only illustrative and any desired number of columns may be used in one or more of the journals.

The transactions recorded in the journals illustrated were completed by J. A. Bryant, a retail merchant, during the monthly fiscal period of December. December 1, the assets, liabilities and proprietorship are shown in the following Balance Sheet:

J. A. BRYANT
BALANCE SHEET, December 1, 19...

Assets			Liabilities		
Cash.....	1222	35	Notes Payable.....	500	—
Notes Receivable.....	725	—	Accounts Payable:		
Accounts Receivable:			Cole Tire Co.....	251	50
Service Tire Shop.....	265	50	Mays Heater Co.....	805	17
Dobbs Bros.....	259	60			
	525	10	Total Liabilities.....	1556	67
Merchandise Inventory.....	5628	40			
Supplies.....	109	65	Proprietorship		
Prepaid Insurance.....	100	—	J. A. Bryant, Capital.....	7238	83
Equipment.....	500	00			
Less Dep. Reserve.....	15	00			
	485	—			
Total Assets.....	8795	50	Total Liabilities and Capital....	8795	50

The transactions completed each day are shown recorded in the illustrations but a narrative is not provided because the nature of these transactions can be determined from the entry in the journal. The rulings in the journals are such that it is not necessary to record one transaction in two journals, that is, each transaction is recorded complete in one journal.

Columnar General Journal. When there are only a few purchases, they may be recorded in the general journal. When this plan is followed, it is customary to provide an additional column in the journal in which to record the amount of each purchase invoice. The purpose of the special column is to make it possible to add all the purchases and post the total to the Purchases account in one amount at the end of the month.

Since purchases of supplies as described in Chapter VIII are not to be recorded in the same account as the purchases of merchandise, these transactions, if the purchase is on credit, will be recorded either in the general journal or in a purchases journal with special columns. When recorded in the general journal, a special column should also be provided in order that all purchases of supplies may be entered, added and posted in one amount.

(Continued on page 147)

December 1, 19-

PAGE 87

L. F.	NAME OF ACCOUNT & EXPLANATION	GENERAL	PURCHASES	SUPPLIES	GENERAL
		DR.	DR.	DR.	CR.
✓ 1	Cash	1227 35			
2	Notes Receivable	725 -			
45	Service Tire Shop	265 50			
46	Dobbs Bros.	259 60			
5	Merchandise Inventory	5628 40			
6	Supplies	109 65			
8	Prepaid Insurance	100 -			
11	Equipment	500 -			
12	Depreciation Reserve				15 -
15	Notes Payable				500 -
60	Cole Tire Co.				251 50
61	Mays Heater Co.				805 17
18	J. A. Bryant Capital				7238 83
	To record the assets, liabilities and proprietorship shown on the Balance Sheet of December 1				
2	Notes Receivable	200 -			
46	Dobbs Bros.				200 -
	20-day 6% notes to apply on December 1 balance.				
3	Cash	4933 3			
43	Interest Expense	66 7			
15	Notes Payable				500 -
	60-day loan from Newell Bank.				
2	Notes Receivable	250 -			
45	Service Tire Shop				250 -
	25-day 6% note to apply on December 1 balance.				
5	Purchases		1061 40		
60	Cole Tire Co.				1061 40
	Invoice Dec. 3, 1/10 - 7/10				
8	Purchases		356 50		
62	Rubber Chain Co., St. Louis				356 50
	Invoice Dec. 6, 1/10 - 7/10				
		7760 50	141 790		11178 40

Illustration 37, General Journal, Page 87

December 10, 19-

PAGE 88

L F	NAME OF ACCOUNT & EXPLANATION	GENERAL		PURCHASES		SUPPLIES		GENERAL	
		DR		DR		DR		CR	
		9760	50	141	770			111	7840
✓ Purchased				92	780				
60	Cole-Tire Co.							92	780
	Invoice Dec. 8, 3/10 - 7/30								
	12								
19	J. A. Brown & Son, Inc.	78	60						
23	Purchased							78	60
	4 30 X 6.00 tires @ \$19.65								
	1								
✓ Supplies						36	50		
63	Johnson Paper Co. 606 Vine St							36	50
	Paper and tissue for store room								
	13								
✓ Purchased				332	90				
60	Cole-Tire Co.							332	90
	Invoice Dec. 12 3/10 - 7/30								
	19								
✓ Purchased				721	25				
60	Cole-Tire Co.							721	25
	Invoice Dec. 17, 3/10 - 7/30								
	20								
22	Sales Returns and Allowances	13	50						
45	Service-Tire Shop							13	50
	6 tubes @ \$2.25								
	22								
✓ Purchased				176	50				
62	Rubber Chain Co.							176	50
	Invoice Dec. 20 3/10 - 7/30								
	22								
✓ Supplies						48	75		
64	Office Supply Co. 12 E. Townsend St.							48	75
	Supplies for office and								
	22								
60	Cole-Tire Co.	15	50						
25	Purchased Returns and Allowances							15	50
	2 chains @ \$7.75								
	24								
60	Cole-Tire Co.	30	50						
25	Purchased Returns and Allowances							30	50
	2 31 X 5.25 tires @ \$5.25								
		98	98	60	35	76	35	85	25
								135	60
								20	

Illustration 37, General Journal, Page 88

December 27, 19-

PAGE 89

L. F.	NAME OF ACCOUNT & EXPLANATION	GENERAL	PURCHASES	SUPPLIES	GENERAL
		DR.	DR.	DR.	CR.
		989860	357634	8525	1356020
✓	Purchases		47815		
24	Freight and Drayage In	2935			
61	Mays Heater Co				50750
	Invoice Dec. 26 mdse \$478.15				
	freight \$29.35; Jan. 15 dating, 3/10-7/30				
	29				
22	Sales Returns and Allowances	850			
2	Notes Receivable	200-			
50	Peters Garage				20850
	30 day 6% note				
	29				
✓	Purchases		20925		
✓	Supplies			1925	
60	Cole Tire Co				22850
	Invoice Dec. 27, 3/10-7/30				
	30				
2	Notes Receivable	100-			
2	Notes Receivable				100-
	30-day 6% note to apply on				
	Tire Shop note of Dec 5				
	30				
22	Sales Returns and Allowances	250			
53	G. A. Wheeler				250
	Imperfect tube				
	30				
2	Notes Receivable	200-			
2	Notes Receivable				200
	30-day 6% note to apply on				
	W. R. Hill note of November 30				
		1043895	426375	10450	480720
		1043895	426375	10450	480720
		(v)	(23)	(6)	(v)

Illustration 37, General Journal, Page 89

(Continued from page 144)

The general journal on pages 145-147 contains a record of credit purchases of merchandise and supplies as well as the transactions of a general nature. The first and last amount columns contain the same information as the two columns in the general journal which you have been using. The second column (from the left) contains the amount of each purchase of merchandise and the third

column (from the left) the amount of each purchase of supplies. This permits recording purchases of merchandise and supplies in the general journal without involving any more work than when the purchases journal is used.

The first entry on page 145 is to record the assets, liabilities and proprietorship of J. A. Bryant as shown by the Balance Sheet on page 144. You will observe that each asset account is debited, and that the Depreciation Reserve, each liability account and the proprietorship account are credited. The Equipment account is debited for cost value, hence the Reserve account will be credited for the recorded depreciation. You will observe that the four money columns are footed at the bottom of each page, the equality of debits and credits proved and the totals forwarded to the next page; this is necessary in order to have available for posting at the end of the month the correct totals of merchandise purchases and supplies purchases.

Columnar Sales Journal. When merchandise sold to out-of-town charge customers is shipped by parcel post, it is necessary for the seller to attach stamps to each package in sufficient amount to pay the transportation. Since it is customary to deliver merchandise only to local customers and to collect from out-of-town customers for prepaid transportation, it will be necessary to include in the invoice the amount of the merchandise and the amount of the

SALES JOURNAL									
December 19--									
DATE	L. F.	ACCOUNT DEBITED	ADDRESS	TERMS	SALE NO.	AMOUNT DR.	SALES CR.	POSTAGE CR.	
1	45	Service Tire Shop	37th Street St.			25.50	25.50		
5	47	Central Garage	17th & June Sts.	2/10- 7/30	502	721.32	721.32		
8	48	B. A. Fall	Franklin	3/10- 7/30	503	1298.75	1298.75		
11	49	C. J. Mead	25 Bay St. Athens	1/10- 7/30	504	35.75	35.75		75
12	45	Service Tire Shop		2/10- 7/30	505	279.95	279.95		
13	50	Peters Garage	314 Broadway	3/10- 7/3		51.42	51.42		
15	51	A. H. Day	Berryville	2/10- 7/3		2.50	2.50		25
15	52	W. O. Davenport				3.55	3.55		25
18	48	B. A. Fall		7/2	503	318.75	318.75		
20	49	C. J. Mead		7/2		75.50	75.50		25
20	53	G. A. Wheeler		7/2		33.75	33.75		1.25
23	52	W. O. Davenport		7/2	502	42.50	42.50		
27	47	Central Garage		7/2		720.42	720.42		
27	48	B. A. Fall		7/2	503	1298.75	1298.75		1.32
31						5170.65			
31	21	Utilities					5171.10		
31	7	Postage							3.58

Illustration 38, Sales Journal

transportation charges. Thus, if the amount of the sale to an out-of-town charge customer is \$36.50 and it requires 40c in stamps to deliver the package by parcel post, the amount of the invoice is \$36.90.

When postage is involved, it is customary to provide a column in the sales journal for the amount of the postage separate from the amount of the merchandise so that the Sales account may be credited for the total sales and an account with Postage credited for the amount of the postage. The charge customer will, of course, be debited with the amount of the merchandise and the postage. When the stamps are purchased, the amount of the cash paid for them is debited to an account with Postage. When the debit from the cash book and the credit from the sales journal is posted to the Postage account, its balance will show the amount of the stamps on hand if no stamps have been used for some other purpose.

The sales journal on page 148 contains a record of some sales on which the transportation is not prepaid and some on which it is prepaid. Three columns are provided, (a) the amount to be debited to the charge customer, (b) the amount to be credited to Sales, and (c) the amount to be credited to Postage. The posting of one of the sales in which postage is involved and the posting of the totals are illustrated on page 152.

Columnar Cash Book. If a transaction is to be recorded and posted quickly, it must be recorded in one journal only. When cash and cash discount are involved, the use of the general journal and cash book requires entries in both books, posting from both, and checking some amounts not posted. When additional columns are provided on the receipts and payments sides of the cash book, the checking is not required, less posting is required, and all the posting is from one journal. This emphasizes the fact that the purpose of special columns in any journal is to provide for a saving of time in (a) recording the transaction, and (b) posting.

If all the cash transactions involve cash discount, each transaction will be recorded as illustrated on pages 142 and 143. Since cash discount is not involved in all transactions, a cash book which contains a record of a variety of transactions is illustrated on pages 150 and 151. The posting to the account with one charge customer, the posting to the account of one creditor and the posting of the totals are illustrated on pages 153 and 154.

The method of recording transactions in the columnar cash book illustrated is explained in the following paragraphs.

(1) Each amount of cash received is recorded in the Net Cash column on the receipts side in which respect this column is the same as the first column in the cash book discussed and illustrated in Chapter IV.

(2) Each amount to be posted to the credit of an account is recorded in the Amount Cr. column on the receipts side. When cash discount is not involved, the amounts entered in the first and third columns are the same;

when cash discount is involved, the difference between the amount entered in the first column and the amount in the third column is recorded in the Sales Discount or second column.

(3) Each amount of cash paid is entered in the Net Cash column on the payments side of the cash book in which respect this column is the same as the first column in the cash book discussed and illustrated in Chapter IV.

(4) Each amount to be posted to the debit of an account is recorded in the Amount Dr. column on the payments side. When cash discount is not involved, the amounts entered in the first and third columns are the same; when cash discount is involved the difference between the amount in the first column and the amount in the third column is recorded in the Purchases Discount or second column.

PAGE 48		CASH		RECEIPTS		NET CASH
DATE	L. F.	ACCOUNT CREDITED	EXPLANATION	AMOUNT CR.	SALES DISCT DR.	DR.
1	✓	Balance		122235		122235
2	46	Dobbs Bros	In full of Dec. 1 bal.	5960		5960
3	✓	Notes Payable	Loan	49333		49333
5	45	Service Tire Shop	In full of Dec. 1 bal.	179078		179078
11	45	Service Tire Shop	Invt. 1/2, less 1%	32650	327	32323
13	2	Notes Receivable	W.D. Myers note	325-		325-
15	41	Interest Income	On above note	244663		244663
15	47	Central Garage	Invt. 1/2, less 2%	72132	1443	70689
18	48	W.C. Trull	Invt. 1/2, less 3%	129875	3896	125979
19	21	Sales	Cash sale	7550		7550
20	49	W.C. Trull	Invt. 1/2, less 1% & 3/4%	457823	5735	452140
22	2	Notes Receivable	Dobbs Bros. note	200-		200-
22	41	Interest Income	On above note	67		67
23	45	Service Tire Shop	Invt. 1/2, less 2%	26645	533	26112
23	19	W.C. Trull	Invt. 1/2, less 2% & 1/2%	516722	6344	504894
29	45	Service Tire Shop	Invt. 1/2, less 3%	30077	1502	28575
30	2	Notes Receivable	Service Tire Shop note	150-		150-
30	41	Interest Income	On above note	104		104
30	53	W.C. Trull	Invt. 1/2, less 10% and allow.	9243	912	8331
30	2	Notes Receivable	W.R. Hill note	200-		200-
30	41	Interest Income	On above note	2		2
31	15	Notes Payable	Loan	1000-		1000-
31	✓	Total Credits	2000.68	685886	8782	677104
31	42	Sales Discount Dr.	Total discount		8782	
31	1	Cash Dr.	Total receipts			677104
Jan. 1	✓	Balance				2000.68

Illustration 39, Receipts Side of Cash Book

Proving Cash. Cash is proved by adding the three columns on each side; the difference between the total of the Net Cash column on the receipts side and the Net Cash column on the payments side should be the cash balance and agree with the bank balance as shown by the check stub plus any cash on hand. The other two columns on each side are footed to prove the totals of these. The total of the Amount column less the total of the Discount column should be the same as the total of the Net Cash column. This proof of the totals of the columns applies to both the receipts and payments sides of the cash book.

Posting from the Sales Journal. The accounts illustrated on page 152 show the method of posting the fourth sale in the sales journal on page 148 and the totals at the end of the month. Each amount in the Accounts Receivable column is posted daily or frequently during the month; the amounts in the

CASH				PAGE 49		
December, 19--				PAYMENTS		
DATE	L. F.	ACCOUNT DEBITED	EXPLANATION	AMOUNT DR.	PUR. DISCT. CR.	NET CASH CR.
1	25	Rent Expense	December rent	12 50		112 50
1	60	Cole Tire Co	Bal. Dec. 1 less 3%	25 50	7 50	243 95
3	24	General Expense	Telephone bill	50		50
6	61	Mays Heater Co	Bal. Dec. 1 less 1%	25 50	2 50	247 62
10	7	Postage	Stamps	20		20
13	60	Cole Tire Co	Inv. 1/2 less 3%	106 140	31 84	1029 56
16	29	Salary Expense	Salaries Dec. 1-15	142 50		142 50
16	24	Freight & Travel Exp	December 1-15	56 35		56 35
16	62	Rubber Chain Co	Inv. 1/2 less 3%	356 50	10 70	345 80
18	60	Cole Tire Co	Inv. 1/2 less 3%	92 780	27 83	899 97
19	34	General Expense	December water bill	37 250	5 97	365 75
22	60	Cole Tire Co	Inv. 1/2 less 3% and return	317 40	9 52	307 88
26	62	Rubber Chain Co	Inv. on pur. of 22nd	404 75	45 49	398 75
29	34	General Expense	Gas and electricity	6 35		6 35
30	15	Notes Payable	First Natl Bank note	50		50
30	49	Interest Expense	On above note	2 50		2 50
30	19	J. A. Bryant, Drawings	Check No. 1	75		75
31	24	Freight & Travel Exp	December 16-31	62 38		62 38
31	29	Salary Expense	Salaries Dec. 16-31	273 75	45 00	228 75
31		Total Debits		476 75		
31	40	Purchases Discount Cr.	Total discount		45 49	
31	1	Cash Cr.	Total payments			477 03
		Balance				228 75
						677 10

Illustration 39, Payments Side of Cash Book

other columns are not posted daily but the totals of each column are posted at the end of the month. You will observe that a Balance column is provided in the account with the charge customer; this Balance column is usually used only at the end of the month and the balance ascertained at that time for the monthly Trial Balance is entered in this column instead of in the explanation column. The Sales account is credited with the total of the Sales, Cr. column and the Postage account credited with the total of the Postage, Cr. column.

PAGE 45

Postage

PAGE 7

Sales

PAGE 21

The total of all the amounts posted to the debit side of the accounts with charge customers will be the same as the total of the credits to Sales and Postage. This maintains the equality of the debits and credits in the ledger. The accountant should prove that the total of the Amount Dr. column in the sales journal equals the sum of the totals of the two columns at the right of it, as an error in addition would affect the Trial Balance.

Posting from the General Journal. The account in the illustration below shows the posting of the December 5 entry in the general journal, page 145, and the accounts at the top of page 153, the posting of the totals of the two special columns at the end of the month as shown on page 147. The amounts in the General Dr. and Cr. columns are posted frequently during the

PRICE 60

Cole Tire Co

Revision

DATE	EXPLANATION	F	DEBIT	CREDIT	MONTHLY BALANCE
Dec. 5	Dec. 3, 3/10 - 7/30	8	5	106	140

month; the amounts in each of the center columns are not posted daily but the totals of each are posted at the end of the month. The sum of the totals of the two debit columns should equal the sum of the totals of the two credit columns. This proof should be made before the totals are posted at the end of the month.

PAGE 6

19

Dec. 31

89 10450

Purchases

PAGE 23

19

19 Dec. 31

89 426375

Posting the Receipts Side of the Cash Book. The accounts illustrated below show the posting of the entry of December 20 in the cash book, page 150, and the totals at the end of the month. The account with the charge customer in this illustration is the same as the one in connection with the posting from the sales journal; the account is in balance and is ruled to indicate that the credits equal the debits at the point of ruling.

C. J. Mead

25 Bay St. Athens

PAGE 49

DATE	EXPLANATION	F	DEBIT	CREDIT	MONTHLY BALANCE
19					
Decr. 11	1/10 - 7/30	✓	504	35 -	
11	Postage			75	
20		✓	48		3575

Cash

PAGE 1

19

Dec. 31

C 48 677104

Sales Discount

PAGE 42

Dec. 31

0.48 8782

The amounts entered in the first column are posted daily or frequently during the month. Each amount entered in the columns at the right of this is not posted daily. At the end of the month, the total of the Sales Discount, Dr.

column is posted to the debit of the Sales Discount account and the total of the Net Cash column (less the cash balance at the beginning of the month*) is posted to the debit of the Cash account.

Posting the Payments Side of the Cash Book. The accounts illustrated below show the posting of (a) the entry for December 18, and (b) the totals at the end of the month. The account with the creditor illustrated here is the same as the one illustrated in connection with posting from the general journal.

Colective Co
Buffalo

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DATE	EXPLANATION	F.	DEBIT	CREDIT	MONTHLY BALANCE
Dec. 5	Dec 3, 3/10-7/30	L 87		106140	
13		C 49	106140		

Cash

PAGE 1

Dec 31	C 48	677104	Dec. 31	C 49	477036
--------	------	--------	---------	------	--------

Purchased Discount

PAGE 40

Dec 31	C 49	9549
--------	------	------

The amounts in the first column are posted daily or frequently during the month. Each amount entered in the second and third columns is not posted daily. At the end of the month the total of the Purchases Discount, Cr. column is posted to the credit of the Purchases Discount account and the total of the Net Cash column is posted to the credit of the Cash account.

*NOTE. The cash balance at the beginning of the month may be entered at the left of the money column instead of in the Net Cash column. When this plan is followed, the beginning balance is added to the Net Cash total each time cash is proved and it is not necessary to subtract when posting the total at the end of the month.

REPORTS

Complete Report No. 39 in the work book and present it for approval. You will follow the instructor's directions regarding completion of the next practice set.

CHAPTER XIII

WORK AT THE CLOSE OF THE FISCAL PERIOD

The discussion and illustrations in this chapter are a review of Chapter VI in that they relate to the work required of the accountant at the close of a fiscal period. The illustrations in this chapter contain the account balances in the ledger resulting from posting the journals illustrated in Chapter XII.

Fiscal Period. An accounting period of one or more months and not exceeding twelve months is referred to as a *fiscal period*. At the beginning of each fiscal period the account balances in the ledger contain the same information as the equation "Assets = Liabilities + Proprietorship."

Each transaction completed during a fiscal period is a change in assets, liabilities, assets and liabilities or assets and proprietorship. Each transaction is recorded so as to maintain the equality of the two sides of the equation "Assets = Liabilities + Proprietorship." The monthly Trial Balance is prepared to prove that this equality has been maintained.

Changes in assets, liabilities and proprietorship may occur during the fiscal period and not be recorded at the time they occur. These include (a) the change in the asset merchandise when a sale is made, (b) the change in the asset supplies or prepaid insurance which is occurring daily, and (c) the decrease in the value of the equipment because of its daily use. Those changes in assets, liabilities and proprietorship which occur daily during the fiscal period but which are not recorded at the time they occur must be recorded at the close of the fiscal period in order that the account balances in the ledger will show correct information in regard to the assets, liabilities and proprietorship.

At the close of each fiscal period, the amount of each asset of a tangible nature, such as cash, notes receivable, merchandise, supplies and equipment, is ascertained by count. The count of the assets cash and notes receivable should agree with the balances of these accounts in the ledger. The count of the assets merchandise and supplies will not agree with the account balances in the ledger because of the changes which were not recorded at the time they occurred as explained above.

Each transaction is recorded in a journal at the time it is completed in such a manner as to maintain the equality of debits and credits. The monthly Trial Balance is prepared to prove that this equality of debits and credits has been maintained. The fact that the ledger is in balance permits using the balances of the Cash, Notes Receivable, Accounts Receivable, and Equipment accounts as a basis for proof of the count, and the balances of the Merchandise Inventory, Purchases account and Supplies account as a basis for recording the changes in these assets because of sale or units of supplies used. It is well to observe, however, that the amount of the merchandise and supplies ascertained by count cannot be proved to be correct through the account balances in the ledger.

Accounting at the Close of the Fiscal Period. As explained in Chapter VI, the work of the accountant at the close of the fiscal period includes the following:

(1) Ascertaining the value of the merchandise, supplies and equipment on hand; the clerks count and list the merchandise and the accountant ascertains the value.

(2) Ascertaining the present proprietorship, net profit and proof of their correctness; the Work Sheet is prepared for this purpose.

(3) Preparation of two reports, the Balance Sheet showing assets, liabilities and proprietorship and the Profit and Loss Statement showing income, expense and net profit.

(4) Recording in the general journal the entries necessary to record the changes in assets, liabilities and proprietorship which have occurred during the fiscal period but which were not recorded at the time they occurred; these are referred to as *adjusting entries*.

(5) Recording in the general journal the entries necessary to transfer through the Profit and Loss Summary account the account balances which show increases in proprietorship (income) and decreases in proprietorship (expense) to the Capital account; these are referred to as *closing entries*. The credit balance of the Capital account at the beginning of each fiscal period should show the same proprietorship as that shown on the Balance Sheet.

(6) Balancing the Cash, Capital, and deferred asset accounts.

(7) Proving that the ledger is in balance through a Post-closing Trial Balance.

Comparing the above outline with that given on page 64, you will observe that additional work is suggested as follows:

(1) Ascertaining the value of three additional kinds of property, (a) supplies, (b) prepaid insurance, and (c) equipment.

(2) Arranging the adjusting and closing entries in two separate groups and the closing entries in four groups; the four groups of closing entries are (a) trading accounts, (b) expense accounts, (c) non-operating income accounts, and (d) deductions from income accounts.

(3) The balancing of two additional accounts, Supplies and Prepaid Insurance.

In other words, the work at the close of the fiscal period is always the same but may involve more work of a similar type because of additional information needed. When the merchant does not have supplies or equipment, there will be only one asset to ascertain by count and that is merchandise; when he has supplies and equipment, these must be counted.

You will observe that there are no account balances in the ledger which show the asset value of merchandise or supplies in stock, hence the count can not be verified with an account in the ledger. The balance of the Equipment account does show the cost price of all the equipment purchased, hence the

equipment inventory should agree with the value of the Equipment account, the same as the cash on hand ascertained by count should agree with the balance of the Cash account.

Illustrations. J. A. Bryant, the retail merchant referred to in Chapter XII, operates on a monthly fiscal period basis. The accountant recorded the transactions completed during the December fiscal period as shown in the illustrations in Chapter XII. December 31, J. A. Bryant wishes to know the amount of profit earned as a result of the transactions completed during the month, hence instructs his clerks to ascertain by count the number of units of each kind of merchandise, supplies and equipment in stock. The accountant has ascertained the value of each asset from the cost price. These values are:

Merchandise Inventory.....	\$5896.13
Supplies Inventory.....	186.65
Postage Inventory.....	9.57
Prepaid Insurance.....	90.00
Equipment Inventory:	
Cost.....	\$500.00
Book Value, December 1.....	485.00
Depreciation for December.....	5.00

The value of the prepaid insurance is ascertained by the accountant from the insurance policy, each policy showing the amount of the premium and the number of months for which the premium provides protection. The cost value of the equipment is ascertained from the Equipment account and the book value, December 1, from the Equipment account and the credit balance of the Depreciation Reserve account. The depreciation on equipment for December is based on an estimated life of 100 months, hence the amount of depreciation to be recorded December 31 is 1/100 of \$500.00, or \$5.00.

Work Sheet. The purpose of the Work Sheet in Illustration 40 is to ascertain the proprietorship December 31, the net profit for the month of December, and proof of their correctness. This Work Sheet was prepared by the accountant for J. A. Bryant at the close of the December fiscal period from the account balances in the ledger resulting from posting the books of account illustrated in Chapter XII, and the inventories given above. This additional information is required because the asset value of the merchandise and supplies in stock, the unexpired insurance, and the book value of the equipment can not be ascertained from account balances in the ledger. This information can not be obtained from account balances because the changes in the assets, merchandise because of sales, supplies because of supplies used, prepaid insurance because of the time element, and the equipment because of the decrease in value resulting from use, were not recorded at the time the changes occurred.

Accounts with Supplies Used, Expired Insurance and Depreciation Expense are written on the Trial Balance although they have no balances. These accounts were opened in the ledger at the close of the preceding fiscal period and will be needed in the adjustments required for preparing the Work Sheet.

J. A. Bryant
Work Sheet December 31, 19--

NAME OF ACCOUNT	TRIAL BALANCE		ADJUSTMENTS		TRADING		P & STATEMENT		BALANCE SHEET	
	DR.	CR.	DR.	CR.	DR.	CR.	EXPENSE	INCOME	ASSETS	LIAB&PROP.
Cash	200068								200068	
Notes Receivable	500-								500-	
Central Garage	76942								76942	
B. A. Fall	45682								45682	
C. J. Mead	7642								7642	
A. H. Day	11378								11378	
W. O. Davenport	42650								42650	
Merchandise Inventory	562840				562840	582613			589613	
Supplies	21415			2750					18665	
Postage	1442			485					1927	
Prepaid Insurance	100-			10-					90-	
Equipment	500-								500-	
Depreciation Reserve		15-		5						20-
Notes Payable		1500-								1500-
Cole Tire Co		91925								91925
Mays Water Co		50750								50750
Rubber Chain Co		15775								15775
Johnson Tape		3650								3650
Office Supply Co		4875								4875
J. A. Bryant Capital		723893	15360							708533
J. A. Bryant Drawing	15360			75360						
Sales		524960				524960				
Goods Returned and Allowances	2050					2050				
Purchases	418515				418515					
Freight & Drayage In	14808				14808					
Purchased Returns & Allowances		46-				46-				
Gen'l Expense	11250						11250			
Salary Expense	28225						28225			
Supplies Used				2750			2750			
Postage Used				485			485			
Expired Insurance				10-			10-			
Depreciation Expense				5-			5-			
General Expense	1625			1			1625			
Purchased Discount		9549						9549		
Interest Income		534						534		
Series Discount		8782						8782		
Interest Expense	917						917			
	1582200	1582200	20095	20095	991613	1119173	55544	60993	202597	202597
Gross Trading Profit						120560		120560		
Net Profit							75099			75099
						1119173	130643	130643	1102597	1102597

Illustration 40, Ten-column Work Sheet

Method of Preparing the Work Sheet. The information in the following paragraphs is given in the order in which the accountant completed the work on the Work Sheet and is the order which you should follow when completing similar work. The information relates not only to the method of doing the work but also to the reason for doing it.

Check each paragraph with the illustrations. Keep in mind the fact that this is the same work and done for the same purpose as the Work Sheet on page 66. There are more columns and more adjustments in the Work Sheet on page 158 because there were more changes in assets which were not recorded at the time the changes occurred.

(1) The December 31 Trial Balance which contains the same facts as the ledger on that date is copied in the first two columns at the left of a sheet ruled with ten columns. Two columns are provided for the Trial Balance, two for the Adjustments, two for Trading, two for the Profit and Loss Statement, and two for the Balance Sheet.

(2) The merchandise inventory, \$5,896.13, is entered in the Assets and Trading, Cr. columns. This is an asset because it is the value of the merchandise on hand; the same amount is entered in the Trading, Cr. column because it is to be subtracted from the sum of the merchandise inventory and purchases which will be later extended into the Trading, Dr. column.

(3) The supplies inventory, \$186.65, is entered in the Assets column and \$27.50, the difference between the debit balance of the Supplies account and the inventory, is entered in the credit Adjustments column on a line with Supplies and in the debit Adjustments column on a line with Supplies Used. The inventory is an asset but it is \$27.50 less than the cost value of the supplies purchased, hence it is desired to show that \$27.50 is to be subtracted from the debit balance of the Supplies account and recorded as a debit to the Supplies Used account.

(4) The asset value of the prepaid insurance, \$90.00, is entered in the Assets column and \$10.00, the difference between the debit balance of the Prepaid Insurance account and the inventory, is entered in the credit Adjustments column on a line with Prepaid Insurance and in the debit Adjustments column on a line with Expired Insurance. The inventory is an asset but it is \$10.00 less than the cost value of the insurance, hence it is desired to show that \$10.00 is to be subtracted from the debit balance of the Prepaid Insurance account and recorded as a debit to the Expired Insurance account.

(5) The \$5.00 depreciation applicable to the December fiscal period is entered in the Adjustments, Cr. column on a line with Depreciation Reserve and in the Adjustments, Dr. column on a line with Depreciation Expense. The Depreciation Reserve account is a minus asset, that is, the credit balance of this account is a deduction from the debit balance of the Equipment account to ascertain the book value of equipment. The estimated depreciation is an expense because the asset Equipment has decreased because of use.

(6) The balance of each of the first seven accounts on the Trial Balance is extended into the Assets column because each of these accounts represents an asset. The balance of the Cash account was proved by count and the notes receivable and accounts receivable were proved through the Trial Balance.

(7) The balance of the Merchandise Inventory account is extended into the debit Trading column. The purpose of the Trading columns is to provide for ascertaining the total of the trading accounts with a debit balance and the total of the trading accounts with a credit balance including the December 31 merchandise inventory so that the gross trading profit may be ascertained. When the trading accounts are used, the trading accounts are not adjusted through the Adjustments columns but all the needed facts in regard to them are recorded in the Trading columns of the Work Sheet.

(8) The amount in the credit Adjustments column on a line with Supplies is subtracted from the debit balance of the Supplies account in the Trial Balance, Dr. column to prove that the amount \$186.65 entered in the Assets column is correct. The cost of all the supplies purchased less the cost of those which have been used should be the asset value of those on hand.

(9) The \$10.00 in the credit Adjustments column on a line with Prepaid Insurance is subtracted from the debit balance of the Prepaid Insurance account in the Trial Balance, Dr. column to prove that the \$90.00 entered in the Assets column is correct. The reason here is the same as that given in the preceding paragraph.

(10) The balance of the Equipment account in the Trial Balance column is extended into the Assets column. The \$5.00 in the credit Adjustments column on a line with Depreciation Reserve is added to the credit balance of the Depreciation Reserve account in the Trial Balance, Cr. column and the total extended into the Liabilities and Proprietorship column.

If desired, the present book value of the equipment (debit balance of the Equipment account less the sum of the reserve recorded in a previous period and that to be recorded at the close of this fiscal period) may be extended into the Assets column. The final results are the same with either method, but the plan illustrated is usually used because it provides in the Balance Sheet columns the information regarding Equipment and Reserve for Depreciation needed in preparing the Balance Sheet.

(11) The balances of the Notes Payable account and the account with each creditor in the Trial Balance, Cr. column are liabilities, hence extended into the Liabilities column. These were proved to be correct through the Trial Balance.

(12) The amount in the debit Trial Balance column on a line with J. A. Bryant, Drawing is to be subtracted from the amount in the credit Trial Balance column on a line with J. A. Bryant, Capital, hence the \$153.60 entered

in the debit and credit Adjustments columns. The extension is made as indicated in the Adjustments column, that is, \$7,085.23 (\$7,238.83 - \$153.60) entered in the Liabilities and Proprietorship column. This amount is entered in the same column with the liabilities to show that the sum of the liabilities and proprietorship equals the assets.

(13) The trading accounts are Sales, Sales Returns and Allowances, Purchases, Freight and Drayage In, and Purchases Returns and Allowances. The credit balance of the Sales account is entered in the Trading, Cr. column, the debit balance of the Sales Returns and Allowances account in the Trading, Dr. column, the debit balance of the Purchases account in the Trading, Dr. column, the debit balance of the Freight and Drayage In account in the Trading Dr. column, and the credit balance of the Purchases Returns and Allowances in the Trading, Cr. column. These account balances as well as the debit balance of the Merchandise Inventory and the amount of the December 31 inventory are extended into the Trading columns because the gross trading profit is the total of the trading accounts with a credit balance and the ending merchandise inventory minus the total of the trading accounts with a debit balance.

(14) The amount in the debit Trial Balance column on a line with each of the three expense accounts is extended into the Expense column. Each expense account with a debit balance is a deduction from the profit which will later be entered in the Income column.

(15) Each amount in the debit Adjustments column on a line with the three expense accounts resulting from supplies used, expired insurance, and depreciation on equipment are extended into the Expense column. Each of these are expense accounts and each has a debit balance.

(16) The amount in the credit Trial Balance column on a line with Interest Income and the amount in the same column on a line with Purchases Discount are each extended into the Income column because each is an increase in proprietorship (income), hence has a credit balance.

(17) The amount in the debit Trial Balance column on a line with Interest Expense and in the same column on a line with Sales Discount are each extended into the Expense column because each is a decrease in proprietorship (expense), hence has a debit balance.

(18) Each of the eight columns at the right of the Trial Balance are footed to ascertain the total. The footings are entered with small figures on the blue line below the last entry which is in the Expense column.

(19) The totals of the Adjustments columns are proved. The total of the debit adjustments must equal the total of the credit adjustments.

(20) The difference between the total of the Trading, Cr. and the total

of the Trading, Dr. column is the gross profit on sales. This amount is ascertained but not entered until the Profit and Loss Statement and Balance Sheet columns have been proved.

(21) The sum of the Income column and the gross trading profit less the total of the Expense column is the net profit. This amount is ascertained but not entered until the Balance Sheet columns have been proved.

(22) The total of the Assets column should equal the sum of the Liabilities and Proprietorship column and the net profit. This proof is effected through adding to the total of the Liabilities and Proprietorship column the net profit ascertained as explained in (21) above. When this proof has been made, the gross trading profit and net profit may be entered in the proper columns.

(23) The gross trading profit is entered in the debit Trading column to make the Trading, Dr. and Cr. columns balance. It is also extended into the Income column to be added to the other income. The net profit is entered in the Expense column to make the Profit and Loss Statement columns equal. It is also entered in the Liabilities and Proprietorship column to make the Balance Sheet columns equal. The totals of the various columns are entered and the Work Sheet is ruled as in Illustration 40.

(24) Care is used in proving the work in each step required to complete the Work Sheet because the Work Sheet is used as a basis for preparing the Balance Sheet and Profit and Loss Statement, recording the adjusting entries and recording the closing entries. The fact that the total of the debit Trial Balance equals the total of the credit Trial Balance column indicates that the equality of debits and credits has been maintained in the ledger. The total debit Adjustments column equals the total credit Adjustments column which indicates that the equality of debits and credits has been maintained when recording the adjustments. The total of the trading accounts with a debit balance plus the gross trading profit equals the total of the trading accounts with a credit balance and the December 31 merchandise inventory. The total of the Expense column plus the net profit equals the total income. The total of the Assets column equals the sum of the total of the Liabilities column, the net investment and the net profit.

Balance Sheet. The Balance Sheet in the illustration on page 163 was prepared by the accountant from the Balance Sheet columns of the Work Sheet, page 158. The accounts are arranged in the ledger in the order in which the assets and liabilities are classified on the Balance Sheet. This means that all the figures for preparing the Balance Sheet are in the proper order in the Balance Sheet columns but the accountant must indicate the classification.

The Balance Sheet in the illustration is prepared in report form. The same facts stated in equation form in totals only are:

ASSETS \$11,005.97 — LIABILITIES \$3,169.75 = J. A. BRYANT, CAP. \$7,836.22

J. A. BRYANT

BALANCE SHEET, DECEMBER 31, 19..

ASSETS		
Current Assets:		
Cash	2000.68	
Notes Receivable	500.00	
Accounts Receivable:		
Central Garage	769.42	
B. A. Fall	456.82	
C. J. Mead	76.42	
A. H. Day	113.78	
W. O. Davenport	426.50	1842.94
Merchandise Inventory	5896.13	
Total Current Assets		10239.75
Deferred Charges:		
Supplies	186.65	
Postage	9.57	
Prepaid Insurance	90.00	
Total Deferred Charges		286.22
Fixed Assets:		
Equipment	500.00	
Less Depreciation Reserve	20.00	
Total Fixed Assets		480.00
TOTAL ASSETS		11005.97
LIABILITIES		
Current Liabilities:		
Notes Payable	1500.00	
Accounts Payable:		
Cole Tire Co.	919.25	
Mays Heater Co.	507.50	
Rubber Chain Co.	157.75	
Johnson Paper Co.	36.50	
Office Supply Co.	48.75	1669.75
TOTAL LIABILITIES		3169.75
PROPRIETORSHIP		
J. A. Bryant's Capital, December 1	7238.83	
Add Net Profit for December	750.99	
Less Withdrawals for December	153.60	
Net Increase in Proprietorship	597.39	
TOTAL PROPRIETORSHIP		7836.22

Illustration 41, Balance Sheet

Analysis of Proprietorship. The information regarding drawings and net profit shown on the Balance Sheet above is obtained from the Trial Balance and Balance Sheet columns of the Work Sheet. This report may be made a part of the Balance Sheet as illustrated here, or it may be submitted to the proprietor on a separate report known as an Analysis of Proprietorship. The usual plan of presenting this information to the proprietor is as shown in the illustration.

J. A. BRYANT

PROFIT AND LOSS STATEMENT FOR MONTH ENDING DECEMBER 31, 19..

Merchandise Sales:		
Gross Sales.	5249.60	
Less Sales Returns and Allowances.	24.50	
Net Sales.		5225.10
Cost of Merchandise Sold:		
Merchandise Inventory, December 1.	5628.40	
Purchases.	4185.15	
Less Returns and Allowances.	46.00	
Net Purchases.	4139.15	
Freight and Drayage In	148.08	
Total Cost of Merchandise Available for Sale	9915.63	
Less Inventory, December 31.	5896.13	
Cost of Merchandise Sold		4019.50
Gross Profit on Sales		1205.60
Operating Expense:		
Rent Expense	112.50	
Salary Expense	282.25	
Supplies Used.	27.50	
Postage Used	4.85	
Expired Insurance.	10.00	
Depreciation Expense	5.00	
General Expense.	16.35	
Total Expenses		458.45
Net Profit from Operations.		747.15
Other Income:		
Purchases Discount	95.49	
Interest Income.	5.34	
Total Other Income		100.83
Gross Income.		847.98
Deductions from Income:		
Sales Discount	87.82	
Interest Expense	9.17	
Total Deductions from Income		96.99
Net Profit.		750.99

Illustration 42, Profit and Loss Statement

Profit and Loss Statement. The Profit and Loss Statement in the illustration above was prepared by the accountant from the Trading and Profit and Loss columns on the Work Sheet, page 158. The information in the debit and credit Trading columns is shown first followed by the information in the Profit and Loss Statement columns.

The method of showing interest income and purchases discount as *other income* and interest expense and sales discount as *deductions from income* is

consistent with modern accounting practice. If desired, however, the other income may be reported immediately following income from sales and deductions from income immediately following expenses.

REPORT

Complete Report No. 40 in the work book and present to the instructor for approval. While waiting for it to be approved, proceed with the text discussion preparatory to completing Report No. 41 on page 170.

Adjusting Entries. As explained in connection with the work at the close of the fiscal period, the purpose of the adjusting entries is to record in the ledger through posting journal entries the additions and subtractions indicated by the entries in the debit and credit Adjustments columns and the ending inventory in the Trading, Cr. column. The entries in the illustration below were made by the accountant using the amounts in the Adjustments columns as a basis for the debits and credits. The entries are made in the same order as the amounts appear in the Adjustments columns. The purpose of each entry is briefly described as follows:

(1) The purpose of the first entry is to record the decrease in proprietorship (expense) and decrease in assets because of the supplies used during the fiscal period, the expired insurance during the fiscal period and the estimated

Adjusting Entries *December 31, 19-*

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L. F.	NAME OF ACCOUNT	&	EXPLANATION	GENERAL LEDGER DR.	PURCHASES DR.	SUPPLIES DR.	GENERAL LEDGER CR.
30	Supplies Used			2750			
31	Postage Used			485			
32	Expired Insurance			10 -			
33	Depreciation Expense			5 -			
6	Supplies						2750
7	Postage						485
8	Prepaid Insurance						10 -
12	Depreciation Reserve						5 -
	To record supplies and postage used, expired insurance and depreciation expense for December.						
	31						
18	J. A. Bryant, Capital			15360			
19	J. A. Bryant, Drawing						15360
	To transfer balance of Drawing account to the Capital account.						

Illustration 43, Adjusting Entries

decrease in the value of equipment because of use during the fiscal period. One compound entry is sufficient to record these facts but three separate entries may be made if desired.

(2) The purpose of the second entry is to transfer the balance of the Drawing account to the Capital account. The Drawing account is credited and the Capital account is debited because the entries in the Adjustments columns indicate subtraction from the Drawing account and subtraction from the Capital account. Debiting the Capital account subtracts the amount from the credit balance and crediting the Drawing account subtracts the amount from the debit balance.

Closing Entries. As explained in Chapter VI, the purpose of the closing entries is to transfer to the Capital account through a summary account the account balances which show decreases in proprietorship (expense) and increases in proprietorship (income). The entries in the illustration on pages 167 and 168 were recorded by the accountant using the information in the Trading and Profit and Loss columns as a basis for the entries. The purpose of each entry is briefly explained as follows:

(1) The purpose of the first entry is to transfer the trading accounts with a debit balance to the Trading account; the second entry, to record the ending merchandise inventory and to transfer the trading accounts with a credit balance to the Trading account; and the third entry, to transfer the balance of the Trading account (gross profit on sales) to the Profit and Loss Summary account. Each credit amount in the first journal entry is in the debit Trading column, each debit amount in the second journal entry is in the credit Trading column, and the debit and credit amounts in the third entry are in the Trading, Dr. and Income columns.

The entries required when the Trading account is used differ slightly from those when the gross profit on sales is shown through the Purchases and Sales accounts as in the Work Sheet on page 66 but the final results are the same.

(2) The purpose of the fourth entry is to transfer the balance of each expense account to the Profit and Loss Summary account; the fifth entry, to transfer the balance of the other income accounts to the Profit and Loss Summary account; and the sixth entry, to transfer the balance of the accounts which show deductions from income to the Profit and Loss Summary account. Each credit amount in the fourth entry is in the Expense column, each debit amount in the fifth entry is in the Income column, and each credit amount in the sixth entry is in the Expense column.

When it is desired to transfer an account balance to another account, the account to be transferred is debited if it shows a credit balance and credited if it shows a debit balance; this is necessary so that the amount may be posted to the smaller side and thus bring the account into balance.

Closing Entries
December 31, 1914

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L. F.	NAME OF ACCOUNT & EXPLANATION	GENERAL LEDGER DR.	GENERAL LEDGER CR.
45	Trading	778613	
5	Merchandise Inventory		522840
23	Purchases		418515
24	Purchases Discounts		14808
22	Sales Returns and Allowances		2450
	To close the accounts with a debit balance into the Trading account		
	31		
5	Merchandise Inventory	589613	
21	Notes	174960	
25	Purchases Returns and Allowances	46-	
45	Trading		1119173
	To bring the accounts with a debit balance into the Trading account		
	31		
45	Trading	720558	
46	Profit and Loss Summary		120560
	To close the Trading account		
	31		
46	Profit and Loss Summary	45845	
28	Rent Expense		11250
29	Salary Expense		28225
30	Supplies Used		2750
31	Postage Expense		485
32	Expiration Insurance		10-
33	Depreciation Expense		5-
34	General Expense		1635
	To close the expense accounts		
	31		
40	Purchases Discount	9549	
41	Interest Income	534	
46	Profit and Loss Summary		10083
	To close the other income accounts		
	31		
46	Profit and Loss Summary	9699	
42	Sales Discount		8782
43	Interest Expense		917
	To close the deductions from income accounts		

Illustration 44, Closing Entries

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December 31, 19

L F	NAME OF ACCOUNT & EXPLANATION	GENERAL LEDGER CR	PURCHASES DR	SUPPLIES DR	GENERAL LEDGER CR
46	Profit and Loss Summary	750 99			
18	J. A. Bryant, Capital				750 99
	To close the Profit and Loss Summary account				

Illustration 44, Closing Entries (Concluded)

Posting the Adjusting and Closing Entries. The purpose of recording the adjusting and closing entries in the general journal is to provide a basis for recording them in the ledger. When the accountant completed the adjusting and closing entries in Illustrations 43 and 44, he posted them to the ledger and ruled the accounts which were made to balance because of the posting.

Trading

19	Dec 31	Merch Inv 41	891 50 25 00	19	Dec 31	Merch Inv 41	891 50 25 00
	31	Freight In 891	418 51 15		31	Sales 891	32 00 00
	31	Interest Expense 41	145 00		31	Interest Income 891	95 49
	31	Sales Ret & Allow 891	2450				
	31	Profit on Sales 891	1205 60				
			<u>1119 173</u>				<u>1119 173</u>

Profit and Loss Summary

19	Dec 31	Rent Expense 891	112 50	19	Dec 31	Profit on Sales 891	1205 60
	31	Freight Expense 891	25 00		31	Interest Expense 891	95 49
	31	Supplies Used 891	2750		31	Interest Income 891	130 23 45
	31	Postage Used 891	485				
	31	Expired Ins 891	10 -				
	31	Depreciation Exp 891	5 -				
	31	Interest Expense 891	1135				
	31	Sales Discount 891	878 20				
	31	Interest Expense 891	917				
	31	J. A. Bryant, Capital 891	750 99				<u>1306 43</u>
			<u>1306 43</u>				

As explained on page 139, these two accounts may be combined into one account with the title, Trading, Profit and Loss Summary. When this is done,

the account is balanced after the trading accounts have been posted and the profit on sales is brought down below the ruled lines.

The Trading and Profit and Loss Summary Accounts illustrated on page 168 show the result of posting the closing entries illustrated on pages 167 and 168. It is customary when summarizing account balances in summary accounts to write the account title in the explanation column of the summary accounts. This plan facilitates auditing the Profit and Loss Statement and provides in the ledger a summary of the information shown on the statement.

Post-closing Trial Balance. As explained on page 79, the accountant will prove that his ledger is in balance after the adjusting and closing entries are posted by taking a Trial Balance known as the Post-closing Trial Balance. If the adjusting and closing entries are recorded in the general journal as they are stated on the Work Sheet and are posted as stated in the journal, the

J. A. Bryant
Post closing Trial Balance, December 31, 19-

Cash	2000.68	
Notes Receivable	500.00	
Central Garage	769.42	
B. A. Tull	4568.22	
C. J. Mead	76.42	
A. H. Day	113.78	
W. C. Dravenport	426.50	
Merchandise Inventory	5896.13	
Supplies	186.65	
Postage	9.57	
Unpaid Insurance	90.00	
Equipment	500.00	
Depreciation Reserve		20.00
Notes Payable		1500.00
Cole Tire Co		919.25
Mays Heater Co		507.50
Rubber Chain Co		157.75
Johnson Paper Co		36.50
Office Supply Co		48.75
J. A. Bryant, Capital		7836.22
	11025.97	11025.97

Illustration 45, Post-closing Trial Balance

ledger will be in balance. The accountant, however, never takes for granted that it is in balance until he has proved it through the usual means and the only means of proving that the ledger is in balance is through the Trial Balance.

The Post-closing Trial Balance illustrated on page 169 was prepared by the accountant from his ledger after the adjusting and closing entries were posted.

Balancing Accounts. As explained on page 79, it is customary to balance the Cash and the Capital accounts at the close of the fiscal period. As explained in the illustrations in Chapter VIII, it is also customary at the close of the fiscal period to balance the Supplies and Prepaid Insurance accounts.

To balance an account the balance is entered on the smaller side under the date of the last day of the fiscal period, the account ruled and footed to be sure that it is in balance and the balance entered on the smaller side carried down on the opposite side under date of the first day of the fiscal period. Some accountants use red ink for recording the amount which brings the account into balance; this is a very good practice because it indicates that the account has been made to balance but black ink may be used if desired.

REPORT

Complete Report No. 41 in the work book and present to the instructor for approval. Follow the directions of the instructor in regard to future work.

PART III
PARTNERSHIPS

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CHAPTER XIV

PARTNERSHIP

When the assets used in the operations of a business are owned by one person, the business is said to be a *sole proprietorship*; when they are owned by two or more persons under a partnership agreement, a *partnership*. The discussion in this and the seven chapters which follow relates to a partnership; the preceding chapters relate to a sole proprietorship.

Partnership. The contract relation existing between two or more persons who have associated their assets, time, labor or skill in some business enterprise for their profit is referred to as a *partnership*, and each member of the association, as a *partner*. The assets required to operate a business and the nature of the business operations will largely determine the advisability of the partnership form of organization.

Two or more persons wishing to engage in a mercantile or manufacturing business may combine their property in order to provide the needed assets to operate a business. One who is operating a business as a sole proprietorship may wish to have as partners those occupying responsible positions in his organization. Two or more skilled mechanics may find it to their advantage to operate a partnership. Two or more professional men such as physicians or attorneys may combine their services to take better care of clients or to secure additional clients.

The purpose of a business whether it is a sole proprietorship or partnership, is to provide a profit for the owner or owners. The profit earned by a partnership is the same as that earned by a sole proprietorship in that it is an increase in the amount of the proprietorship of the business. As explained, proprietorship is the owner's or owners' equity in the assets of the business.

Assets, Liabilities and Proprietorship. Property is needed in the operations of a partnership the same as in a sole proprietorship. Liabilities may be incurred in the operations of a partnership the same as in a sole proprietorship. The amount of the assets of a partnership less the liabilities to be paid out of the assets, is the capital or proprietorship of the partnership. Each partner's equity in the proprietorship of the partnership is determined by the agreement between the partners or, if there is no agreement, by law. The proprietorship of a partnership stated in equation form usually is:

$$\text{ASSETS} = \text{LIABILITIES} + \text{PROPRIETORSHIP}$$

Applying this equation to the proprietorship of the Standard Furniture Co. operated by W. A. Mills and O. C. Wall as equal partners with total assets

of \$6500.00 and total liabilities of \$1250.00 stated in equation form is:

ASSETS \$6,500 LIABILITIES \$1,250 + W. A. MILLS, PROP. \$2,625 + O. C.
WALL, PROP. \$2,625

Articles of Copartnership. The equity of each partner in the assets of a partnership can be determined only from the agreement between the partners usually referred to as the *partnership agreement*. If there is no definite agreement or if there is a dispute between the partners as to the equity of each, the law will determine each partner's equity. When the partnership agreement is in writing, it is referred to as the *articles of copartnership*. It is not essential that the partnership agreement be in writing but it is quite evident that if it is in writing and signed by each partner, there will be less possibility of a misunderstanding on the part of any one or more of the partners.

There should be a sufficient number of copies of the articles of copartnership to provide each partner and the accountant with a copy; the copy supplied the accountant provides a basis for recording the transactions which the business completes with each partner. Each copy of the articles of copartnership should be signed by all of the partners. The following information should be contained in the articles of copartnership:

- (1) The date of the agreement.
- (2) The name and address of each partner.
- (3) The nature of the business.
- (4) The location of the business.
- (5) The date the business is to begin operations and the time it is to continue these operations.
- (6) The firm name under which the business is to be operated.
- (7) The nature of the assets each partner is to invest and the amount of these assets.
- (8) The equity of each partner in the invested assets.
- (9) The duties of each partner.
- (10) The compensation each partner is to receive for the performance of his duties in connection with the partnership operations.
- (11) Each partner's share of the profit or loss resulting from the transactions completed.
- (12) The method of distributing the profit or sharing the loss.
- (13) The method of procedure in case of death or legal disability of either partner or other causes which might terminate the partnership agreement.
- (14) Restraint upon partners as to becoming surety, etc.

The illustration on page 175 shows the articles of copartnership under which W. H. Walker and B. A. Mills have agreed to operate a wholesale shoe business for a period of five years.

ARTICLES OF COPARTNERSHIP

THIS CONTRACT, made and entered into on the first day of July, 1930, by and between W. H. Walker of Indianapolis, Indiana, and B. A. Mills of the same city and state.

WITNESSETH: That the said parties have this day formed a copartnership for the purpose of engaging in and conducting a wholesale shoe business in the city of Indianapolis under the following stipulations which are a part of this contract:

FIRST: The said copartnership is to continue for a term of five years from July 1, 1930, the business to be conducted under the firm name of Walker & Mills at 1214 Washington St., Indianapolis.

SECOND: The investments are as follows: W. H. Walker, \$7,527.63, his proprietary interest in the assets of the business which he has been operating at the above address as shown by a Balance Sheet June 30. The partnership assumes the liabilities shown on this Balance Sheet.

B. A. Mills invests cash, \$2,509.21. These invested assets are partnership property in which the equity of W. H. Walker is two-thirds and B. A. Mills, one-third.

THIRD: Each partner is to devote his entire time and attention to the business and to engage in no other business enterprise without the written consent of the other partner. The specific duties of W. H. Walker will be to have charge of the office and supervise the buying; B. A. Mills will have charge of the sales.

FOURTH: Each partner is to receive an annual salary of \$4,800.00, payable \$400.00 per month in cash or merchandise at cost. These salaries are to be charged as operating expenses of the partnership.

FIFTH: The profits resulting from the operation of the business are to be shared by the partners as follows: W. H. Walker, two-thirds, and B. A. Mills, one-third.

SIXTH: The investment by the partners and transactions completed in the operations of the partnership business are to be recorded so that the changes in assets, assets and liabilities or assets and proprietorship as a result of the transactions completed will be correctly stated in the records. These records are to be open for the inspection of each partner.

Each partner is to receive a monthly Balance Sheet and Profit and Loss Statement showing his proprietorship and net profit. Each partner's share of the net profit is to be credited to his Capital account. Should the operations of the business result in a loss, this loss is to be debited to the partners' Capital accounts in the same proportion as these accounts are credited with the profit.

SEVENTH: The Profit and Loss Statement prepared at the close of June each year will show the net profit or net loss for the twelve preceding months. The Profit and Loss Statement and Balance Sheet prepared at this time will be certified to by a certified public accountant.

EIGHTH: Neither partner is to withdraw any part of his investment or anticipated profit without the written consent of the other partner. Each partner has the privilege of withdrawing 25% of the profit credited to his Capital account within 90 days after July 1 of each year.

NINTH: In case of the death or legal disability of either partner the other partner is to continue the operation of the business until the close of the annual fiscal period June 30 next thereafter. At that time the surviving partner has the privilege of purchasing the proprietary interest of the deceased partner in the partnership proprietorship at 10% above its book value.

TENTH: During the operation of this partnership neither partner is to become surety nor bondsman for anyone without the written consent of the other partner.

ELEVENTH: At the conclusion of this contract, unless it is mutually agreed to continue the operation of the business under a new contract, the assets of the partnership after the liabilities are paid are to be divided in proportion to the net credit to each partner's Capital account on that date.

IN WITNESS WHEREOF, the parties aforesaid have hereunto set their hands and affixed their seals on the day and year above written.

W. H. WALKER [SEAL]

B. A. MILLS [SEAL]

Relation Between Partners. Each partner has agreed to all the articles in the partnership agreement as evidenced by his signature. If the operations of the business are to be successful, it is quite evident that each partner must comply with the conditions in the partnership agreement. It is also quite evident that if either partner fails to comply with any or all the articles in the agreement the operation of the business can not be a success. Lack of good faith on the part of either partner in complying with the articles of copartnership will affect the efficiency of the business and may result in its dissolution by the courts.

Method of Forming a Partnership. A partnership is formed when the partners have signed the articles of copartnership. The investment of each partner and the operations of the partnership is governed entirely by the partnership agreement. The facts stated in the partnership agreement will determine the method of recording the investment of each partner and the transactions which the partnership completes with him. This is especially true because the assets invested by each partner were his own property before the investment but after the investment they are partnership property and subject to the partnership agreement.

Opening Entry for a Partnership. The facts stated in the partnership agreement regarding investments provides a basis for recording the assets invested by each partner. The method of recording the assets invested by each partner will depend upon the nature of the assets. A partnership is usually organized to operate a new business or to continue the operations of a going business.

Opening Entry for a New Business. When the partnership is formed for the purpose of operating a new business, that is, one which has not been in operation, the investment is usually cash, hence the opening entry is made in the cash book. The Cash account is debited for the total cash invested and the Capital account with each partner is credited for the amount he invested.

The cash book entry in the illustration below is to record the \$2,500.00 cash invested by C. H. Bills and the \$2,500.00 cash invested by R. W. Marx who have formed a partnership for the purpose of operating a retail drug store. The date, October 1, is the date of the investment; the amount of the investment is in accordance with the partnership agreement which states: "Each partner is to invest \$2,500.00 in cash."

		CASH		Receipts	
19					
Oct.	1	C. H. Bills, Capital	Investment	2500	—
	1	R. W. Marx, Capital	Investment	2500	—

It is not necessary to write a synopsis of the articles of copartnership in the general journal because the word "Investment" in the explanation column of

the cash book indicates that a copy of the articles of copartnership is on file as a basis for this entry. The accountant should insist upon this copy being provided and filed for reference.

Opening Entry for a Going Business. When a partnership is formed to continue the operations of a going business, the usual purpose is to secure additional capital, though it may be to admit an employee as a partner. Since a going business is one which has been in operation, it will have assets and possibly liabilities at the time the partnership is formed. The nature and amount of each of these assets and liabilities and the owner's equity in them will be shown by a Balance Sheet which will be referred to in the articles of copartnership and made a part of the agreement. The ledger will be closed if it is to be used by the partnership. In other words, the partnership begins a new fiscal period.

July 1. W. H. Walker, wholesale shoe merchant, formed a partnership with B. A. Mills, one of his employees, to continue the operations of his business under the firm name of Walker & Mills. The partnership agreement as it relates to the investments states:

“W. H. Walker invests \$7,527.63, his proprietary interest in the shoe business located at 1214 Washington St., as shown by the Balance Sheet prepared June 30, 19—, which is made a part of this agreement. The partnership assumes the liabilities, \$2,319.65, shown by the Balance Sheet. B. A. Mills invests cash \$2,509.21.”

The investment of W. H. Walker is recorded in the cash book and general journal and that of B. A. Mills in the cash book only. The Balance Sheet in the illustration below is the one referred to in the articles of copartnership and is used as a basis for the entry for the investment by W. H. Walker. The check received from B. A. Mills is the basis for the entry to record his investment.

W. H. WALKER
BALANCE SHEET, JUNE 30, 19...

ASSETS		LIABILITIES	
Cash.....	1355 46	Notes Payable.....	900 —
Notes Receivable.....	312 15	Accounts Payable.....	1419 65
Accounts Receivable.....	1922 42		
Merchandise Inventory.....	5685 12	Total Liabilities.....	2319 65
Equipment.....	620 00		
Less Depr. Reserve.....	<u>110 00</u>	PROPRIETORSHIP	
	510 —	W. H. Walker, Capital.....	7527 63
Supplies.....	62 13		
		Total Liabilities & Proprietorship	9847 28
Total Assets.....	<u>9847 28</u>		

The entries in the general journal and cash book at the top of page 178 are to record the investment of each partner. The amount of each asset shown

on the Balance Sheet is recorded as a debit to the appropriate accounts, the amount of each liability as a credit to the appropriate account and the equity of W. H. Walker as a credit to his Capital account. The equipment is recorded at its book value because this is its cost to the partnership; future depreciation will be based on the cost to the partnership and not on the original cost. The cash invested by each partner is recorded in the cash book; the check marks in the folio columns of the general journal and cash book are to avoid double posting.

July 1, 19...			
√	Cash.....	1355 46	
	Notes Receivable	312 15	
	Accounts Receivable.....	1922 42	
	Merchandise Inventory	5685 12	
	Equipment.....	510 —	
	Supplies.....	62 13	
	Notes Payable.....		900 —
	Accounts Payable.....		1419 65
	W. H. Walker, Capital.....		7527 63
	To record the investment, per Articles of Co-partnership.		

CASH				Receipts	
19 July	1	√	W. H. Walker, Capital	Investment	1355 46
	1		B. A. Mills, Capital	Investment	2509 21

The cash belonging to W. H. Walker will be transferred to the partnership by a check made payable to Walker & Mills. The check invested by B. A. Mills will be signed by him and made payable to Walker & Mills. Both checks will be deposited in the bank to the credit of Walker & Mills. The partnership agreement transfers title to the merchandise, equipment, and supplies, also authorizes recording the liabilities assumed by the partnership.

A Balance Sheet prepared from the account balances in the ledger after the opening entries have been posted which includes the cash balance in the cash book is:

WALKER & MILLS
BALANCE SHEET, July 1, 19....

ASSETS		LIABILITIES	
Cash.....	3864 67	Notes Payable.....	900 —
Notes Receivable.....	312 15	Accounts Payable.....	1419 65
Accounts Receivable.....	1922 42		
Merchandise Inventory.....	5685 12	Total Liabilities.....	2319 65
Equipment.....	510 —		
Supplies.....	62 13		
		PROPRIETORSHIP	
		W. H. Walker, Capital.....	7527 63
		B. A. Mills, Capital.....	2509 21
		Total Proprietorship.....	10036 84
Total Assets.....	12356 49	Total Liabilities & Proprietorship.....	12356 49

The facts stated in this Balance Sheet indicate that each partner's equity in the partnership assets is the ratio of the balance of his Capital account to the total proprietorship, that is, W. H. Walker 75% and B. A. Mills 25%.

REPORT

Complete Report No. 42 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 43 is required on page 182.

Partnership Transactions. A transaction is a change in the partnership (a) assets, (b) liabilities, (c) assets and liabilities, or (d) assets and proprietorship. These changes occur as a result of buying and selling merchandise or services in the usual operations of the business and through investments or withdrawals of assets by the partners.

At the beginning of its operations and after each transaction is completed, the partnership equity in the assets stated in equation form is:

$$\text{ASSETS} = \text{LIABILITIES} + \text{PROPRIETORSHIP}$$

In order to maintain account balances which will show the same facts as this equation it is necessary to record the transactions as follows:

- (1) Increases in assets, increases in expenses, decreases in proprietorship and decreases in liabilities are recorded as *debits* in the appropriate accounts.
- (2) Decreases in assets, increases in liabilities, increases in proprietorship and increases in income are recorded as *credits* in the appropriate accounts.
- (3) Changes in assets, liabilities and proprietorship which occur daily but are not recorded at the time they occur must be recorded as debits and credits in the appropriate accounts *at the close* of the fiscal period.

Transactions with Each Partner. The partnership will perform some transactions with each partner. These transactions relate largely to investment of assets and withdrawal of assets by each partner. In each investment the partnership assets increase and the proprietorship of a partner increases. In each withdrawal the partnership assets decrease and the proprietorship of a partner decreases.

Withdrawals are usually made as compensation for services or are withdrawals of profit. Compensation is usually in the form of a salary allowed each partner. When the salary is paid, it is regarded as a decrease in partnership proprietorship, hence recorded in an account with the title *Partners Salaries*.

Withdrawal of profit may be after the profit is recorded in the Capital account or in anticipation of its being earned. When recorded profit is withdrawn it is a decrease in the proprietorship of the partner and recorded as a debit to his Capital account. When the withdrawal is in anticipation of profit,

it is a decrease in the proprietorship of the partner and recorded in an account containing his name and the word "Drawing."

When a partner withdraws his salary at various times during the month instead of at a stated time, it will be necessary to maintain a salary account with him. This salary account with the partner is debited with the amounts when withdrawn to apply on salary and at the end of the month it is credited with the amount of his salary. The word "Drawing" is used in the title of the account with the partner only when the account is to contain a record of anticipated profit withdrawn by the partner.

The entry in the cash book below shows the method of recording the monthly salaries paid Walker and Mills as authorized in article four of the partnership agreement on page 175. The debit to the Partners Salaries account indicates that this is a decrease in partnership proprietorship, that is, one of the regular operating expenses of the business.

CASH				Payments			
19 July	31	Partners Salaries	Partners Salaries for July	800	—		

The entry in the cash book below is to record a withdrawal of \$100.00 by W. H. Walker in anticipation of profit; it may be assumed that the partners have agreed to withdraw a part of the anticipated profit. The debit to the Drawing account indicates that this is a decrease in the partner's proprietorship because of profit withdrawn in advance of its having been earned.

CASH				Payments			
19 July	14	W. H. Walker, Drawing	Withdrawal	100	—		

The entry in the cash book below is to record a withdrawal by each partner of earned profit as authorized in article eight of the partnership agreement on page 175. Earned profit refers to profit which has been credited to each partner's Capital account, hence this account is debited to record the decrease in proprietorship.

CASH				Payments			
19 Oct.	1	W. H. Walker, Capital	Withdrawal of recorded profit	500	—		
	1	B. A. Mills, Capital	Withdrawal of recorded profit	500	—		

Admission of a Partner. The partners may agree to admit a new partner at any time. Admitting a new partner cancels the partnership agreement and necessitates a new partnership agreement. The conditions in this agreement will determine the method of recording the assets invested by the new partner.

The admission of a new partner begins a new fiscal period. This means that a Balance Sheet and Profit and Loss Statement must be prepared and the ledger closed before the investment of the new partner or partners is recorded. After the investment of the new partner has been recorded, the credit balance of the Capital accounts with the partners should reflect the equity of each in the assets of the new partnership.

Goodwill. When the amount paid for the assets of a going business is greater than the recorded value, the excess of the purchase price over the recorded value is referred to as *goodwill*. Goodwill is recorded only when a business is purchased at a price greater than the value of the assets. In the case of a partnership the goodwill may be recorded in an account with the title Goodwill or through the Capital accounts of the partners. The usual plan is to make the adjustment through the Capital accounts of the partners because there is no purpose in setting up a Goodwill account on the ledger of a partnership. Goodwill is further discussed in connection with corporations in a subsequent chapter.

Retirement of a Partner. One or more partners may retire at any time during the life of the partnership agreement upon the consent of the remaining partners. Of course, a partner can retire without the consent of the others but this would be in violation of the partnership agreement, hence he would be responsible to his partner or partners for any damage resulting from this violation of the contract.

When a partner retires, the assets withdrawn may be equal to or more or less than the amount of his proprietorship in the partnership; this is determined by agreement with the partners. When he withdraws assets equal in amount to his proprietorship, the appropriate asset accounts are credited and his Capital account debited for the credit balance. When the amount of the assets withdrawn is more than his proprietorship, the excess is debited to the Capital accounts of the other partners because giving the retiring partner a greater amount than his proprietorship reduces the proprietorship of the remaining partners. On the other hand, if the retiring partner should receive assets less than the balance of his Capital account, this would increase the capital of the remaining partners.

Capital Account with Each Partner. The purpose of the Capital account of each partner is to contain a record of the changes in the proprietorship of each partner because of investments, withdrawals, profits and losses. The Capital account with each partner is *credited* with increases which are investments and net profit earned and *debited* for decreases which are withdrawals and net losses.

The *credit* balance of the Capital account with each partner is his net investment. The sum of the *credit* balances of the Capital accounts with the partners at the beginning of each fiscal period equals the difference between the total partnership assets and the partnership liabilities.

Partners Salaries Account. The purpose of the Partners Salaries account is to contain a record of the salaries paid the partners as authorized by the partnership agreement. This account is *debited* for the salaries paid each partner; it is usually not *credited*.

The *debit* balance of the Partners Salaries account shows the total expense because of salaries paid the partners. It is a decrease in partnership proprietorship and is closed into the Profit and Loss Summary account.

When reporting partnership income for income tax purpose, the partners' salaries cannot be deducted from the income as an operating expense.

Salary Account with Each Partner. The purpose of a salary account with each partner is to contain a record of his withdrawals on account of salary when his salary is not paid in one amount at stated times or when each partner does not receive the same salary. This account is *debited* with withdrawals at the time these withdrawals are made and *credited* with the partner's salary at the end of the month.

A *debit* balance of this account indicates that the partner has overdrawn his salary and a *credit* balance that he has not withdrawn all of his salary. The account is usually in balance at the close of the fiscal period because each partner would have withdrawn all the salary due him at that time; if not in balance, it is closed into the Capital account.

Drawing Account with Each Partner. The purpose of this account is to contain a record of the decreases in a partner's proprietorship because of his withdrawal of anticipated profit. This account is *debited* with decreases in the partner's proprietorship because of withdrawals in anticipation of profit; it is usually not *credited*.

At the close of the fiscal period the *debit* balance shows the total amount of profit the partner has withdrawn in advance. It is a decrease in his proprietorship and transferred to the debit side of his Capital account.

REPORT

Complete Report No. 43 in the work book and present for approval. Continue with the text discussion until Report No. 44 is required on page 187.

CHAPTER XV

THE DISCOUNT AND TRANSFER OF NOTES RECEIVABLE THE NOTE REGISTER

The method of recording notes receivable (notes or acceptances) when received at face value and collected at maturity is discussed and illustrated in Chapters IX and X. The discussion and illustrations in this chapter relate to the method of recording transactions (a) in which a note or acceptance is received at more or less than its face, (b) in which cash is received for a note receivable before maturity, and (c) in which a note receivable is transferred before maturity. The note register is also discussed and illustrated.

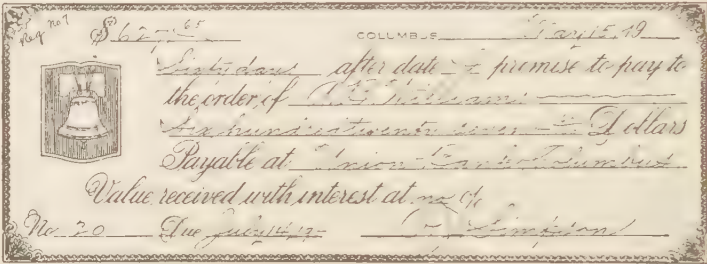
Note Receivable. A note or acceptance owned by the business is an asset described as *note receivable*. A note receivable is usually the result of an extension of time granted to a charge customer. The only exception is the trade acceptance which is a note receivable received from a charge customer at the time the sale is made. A note receivable may be made payable to the business, to the bank that collects it, or it may be transferred to the business by indorsement. A note may be interest-bearing or non-interest-bearing. An acceptance is non-interest-bearing.

Values of a Note Receivable. Each note receivable has three values, (a) the *face*, (b) *maturity value*, and (c) *present value*. The face is the amount stated in the note or acceptance. The maturity value is the amount to be collected at maturity. The present value is the maturity value less the legal rate of interest, or an agreed rate of interest, from the date on which it is desired to ascertain the present value to maturity. If any other method is used to ascertain the asset value of a note at the time it is transferred, it is because of agreement and it is referred to as the *agreed* value. Banks usually apply the present value when receiving a note; mercantile houses use an agreed value.

Notes Discounted by the Business. When the ownership of a note receivable is transferred at any time between date and maturity, the note is said to be *discounted*; notes receivable are not usually transferred after maturity. Thus, a note receivable may be discounted through its transfer *to* the business or through its transfer *by* the business. The present or agreed value at which the note is transferred is referred to as the *proceeds* and the amount of interest involved when the proceeds are less than the face, as *discount*. You should keep in mind the fact however, that discount is only another term used to describe interest when the proceeds of a loan is less than the face of the note discounted.

Note Receivable Discounted by the Business. When a charge customer can not pay his account in cash and it is agreed to allow him credit for the proceeds of a note he owns, this note when transferred to the business is said to be discounted by the business. Usually there are three amounts to record (a) the face of the note, (b) the proceeds of the note, and (c) the interest or discount. When the note is non-interest-bearing, the proceeds will be less than the face of the note; the discount is the difference between the face of the note and the proceeds; if the note is interest-bearing, the proceeds will be greater than the face of the note, the interest being the excess of the proceeds over the face of the note.

A. B. Williams, a charge customer of Walker & Mills, owes a past due balance of \$650.00. He can not pay the amount but agrees to transfer the note in the illustration at the right at its present value (interest 6%) to apply on the past due balance. Walker & Mills accept this proposition and the note is transferred to them by A. B. Williams through indorsement in full. In other words, this note is discounted by Walker & Mills for A. B. Williams. He receives credit for \$624.51, the present value of the note. Maturity value, \$627.65; time between June 14 and July 14, 30 days; interest on \$627.65 for 30 days at 6%, \$3.14; proceeds $\$627.65 - \$3.14 = \$624.51$.



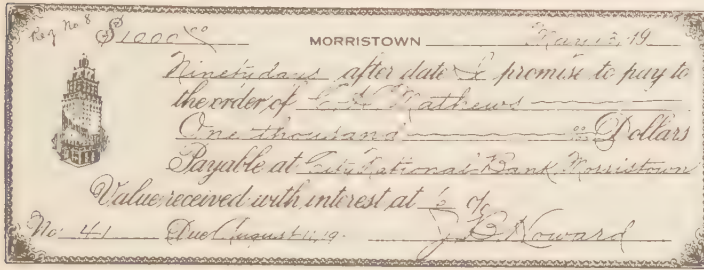
The entry in the illustration at the left is to record in the general journal of Walker & Mills the transaction of June 14 in which the note illustrated above

June 14			
Notes Receivable.....	627 65		
Interest Income.....		3 14	
A. B. Williams.....		624 51	
Discounted note No. 7 for A. B. Williams.			

was discounted by them for A. B. Williams. The Notes Receivable account is debited for the face of the note to record the increase in the asset notes receivable and the account with A. B. Williams credited with the proceeds (present value) to record the decrease in the asset accounts receivable. The credit to the Interest Income account is to record the increase in proprietorship which is the amount of the discount. The "No. 7" in the explanation refers to the description of the note in the notes receivable register, page 190.

The note at the top of page 185 was discounted June 15 by Walker & Mills for C. H. Mathews, the proceeds to apply on a past due account. The

agreement with C. H. Mathews is to allow credit on his account for the face



of this note plus interest at 6% from the date, May 13, to the date of discount, June 15. In other words, the proceeds is the agreed value of the note. Face of the note, \$1,000.00;

interest on \$1,000.00 for 33 days, \$5.50; agreed value, face of the note \$1,000.00 + \$5.50 interest = \$1,005.50.

The entry in the illustration at the right is to record in the general journal of Walker & Mills the transaction in which the note illustrated above was discounted by them for C.

H. Mathews. In this case the proceeds is greater than the face of the note, hence the interest is the difference between the face of the note and the proceeds.

June 15, 19...

Notes Receivable.....	1000—		
Interest Income.....	5 50		
C. H. Mathews.....		1005 50	
Discounted note No. 8 for C. H. Mathews.			

The Notes Receivable account is debited for the face of the note to record the increase in the asset notes receivable and the account with C. H. Mathews is credited for the agreed value to record the decrease in the asset accounts receivable.

The \$5.50 interest is an asset known as *accrued interest* and may be debited to an account with Accrued Interest on Notes Receivable. The Interest Income account, however, is debited because this account will be credited when the \$15.00 interest is collected at maturity. In other words, this is a transaction in which the assets increase and decrease the same amount but a part of the increase in the assets is recorded in the Interest Income account so that it will not be necessary to analyze the transactions when the note is collected to separate the accrued interest recorded in an asset account with the title Accrued Interest and record that part of the interest applicable to income in the Interest Income account.

Notes Discounted for the Business. When the holder of a note receivable needs money before the note matures, he can sell the note to his bank provided his credit rating and that of the maker is satisfactory. When a note receivable is sold to the bank (usually referred to as *discounted by the bank*) the holder will receive credit for the proceeds which is the present value of the note. From the point of view of a banker, the amount of the loan is the maturity value of a note, and in the case of a discounted note, the time is the number of days between the date the note is discounted and the maturity of the note a banker usually collects interest on the amount of a loan at the time of the loan.

June 16. Walker and Mills discounted the note illustrated on page 185 at the Merchants National Bank and received credit for the proceeds, \$1,005.53, rate of interest 6%. From the point of view of the banker the amount of this loan is the maturity value of the note, \$1,015.00, the time of the loan, 56 days, which is the time between June 16 and the maturity of the note, and the proceeds, the maturity value less the interest. Interest on \$1,015.00 for 56 days at 6%, \$9.47; maturity value, \$1,015.00 – \$9.47, interest – \$1,005.53, the proceeds.

The entry in the illustration below is to record the change in assets and proprietorship because of a note discounted. Two entries are required on the receipts side of the cash book because the amount of cash received was more than the face of the note; the Interest Income account is credited to record the increase in proprietorship.

CASH				Receipts	
19 June	16	Notes Receivable Interest Income	Discounted note No. 8 Interest on note No. 8	1000— 5 53	

The face of the trade acceptance in the illustration at the left is recorded as an asset in the Notes Receivable account on the ledger of Walker & Mills.

Reg No 6

TRADE ACCEPTANCE

INDIANAPOLIS

No. 119

To. *Walker Bros.*

On. *August 1*

Pay to the order of *Payee*

Seven hundred and eighty five Dollars, (\$ *785.00*)

The obligation of the acceptor hereof arises out of the purchase of goods from the drawer. The drawer may accept this bill payable at any bank, banker or trust company in the United States which he may designate.

Accepted at *Indianapolis* on *June 14, 19...*

Payable at *Merchants National Bank*

By. *Walker & Mills*

By. *J. B. Wiley*

June 14, Walker & Mills transfer this acceptance to the bank at its present value, rate of interest 6%, and their account is credited with the proceeds, \$712.80. The amount of the

loan is \$718.55, and the discount (interest for 48 days at 6%) \$5.75.

The entries in the general journal at the right and cash book at the top of page 187 are to record this transaction completed by Walker & Mills with the bank in which the trade acceptance was discounted. Entries are required in the general journal and cash book because the amount of cash received is less than the face of the note receivable discounted. The Interest Expense account is debited to record the decrease in proprietorship. The check marks are to avoid double posting. The transaction could be recorded in the cash book only by entering

June 14, 19...			
✓	Cash.....	712 80	
	Interest Expense.....	5 75	
	Notes Receivable.....		718 55
	Discounted acceptance No. 6.		

the face of the draft on the receipts side and the amount of the interest expense on the payments side, but the method illustrated is the more desirable.

				CASH	Receipts	
19						
June	14	✓	Notes Receivable	Proceeds of acceptance No. 6	712	80

A Dishonored Notes Receivable. When the maker of a note refuses to pay or renew it at maturity, the note is said to be *dishonored*. Dishonoring a note receivable does not relieve the maker from responsibility of paying it nor change its asset value as recorded on the books of the holder.

The asset value of a dishonored note may (1) remain in the Notes Receivable account, (2) be transferred to an account with the title Dishonored Notes Receivable, or (3) be transferred to the account with the charge customer from whom it was received. The only purpose in transferring a dishonored note receivable from the Notes Receivable account is to permit this account to show only the face of notes not yet due.

When a note which has not been discounted is dishonored and it is desired to transfer the face value to a Dishonored Notes Receivable account, the general journal entry requires a debit to the Dishonored Notes Receivable account and a credit to the Notes Receivable account for the face of the note; the accrued interest is not recorded. If it is desired to transfer the dishonored note to the account with the charge customer from whom it was received, this account is charged with the maturity value of the note, the Notes Receivable account credited with the face value and Interest Income account credited with the accrued interest.

When a note which has been discounted is dishonored, the bank will present the dishonored note to the one who discounted it and require a check for the maturity value. The account to be debited is indicated on the check stub with an appropriate explanation of the transaction and the entry made in the cash book.

It is necessary to protest a dishonored note which has one or more indorsers on it in order to hold the indorsers responsible for its payment. A note is protested by a notary public who presents it to the maker and notifies the indorsers that the maker has refused to pay it. The holder of the note will pay the notary fees which are known as *protest fees*. When the protested note is charged to the account with the charge customer from whom it was received, his account is also charged with the protest fees.

REPORT

Complete Report No. 44 and present to the instructor for approval. Continue with the text discussion until Report No. 45 is required on page 192.

Contingent Liability. When the title of a note receivable is transferred through indorsement, that is, when the note is discounted, the holder through his indorsement guarantees payment at maturity. This guarantee is an indirect liability on the part of the indorser usually referred to as a *contingent liability*. This contingent liability on the part of the indorser continues until the maker pays the note at maturity. In other words, when the face of a note receivable is collected from the maker, the transaction is completed but when the note is discounted, the transaction is not completed until the maker has paid the note.

Recording Contingent Liability. If desired, the contingent liability because of notes receivable discounted may be recorded at the time each note is discounted. The record is made through crediting an account with the title Notes Receivable Discounted for the face of each note discounted. The Notes Receivable account is not credited for the face of a note discounted until the note is collected by the holder at maturity.

The entry in the cash book below shows the method of recording the contingent liability at the time the note receivable was discounted by Walker & Mills, June 16. You will observe that this entry is the same as the one illustrated on page 186, except that the Notes Receivable Discounted account is credited instead of the Notes Receivable account.

CASH				Receipts
19 June	16 16	Notes Receivable Discounted Interest Income	Discounted note No. 8 Interest on note No. 8	1000— 5 53

The general journal entry in the illustration at the right is to record the contingent liability at the time the acceptance was discounted by Walker & Mills, June 14, as illustrated on page 186. The entry is the same as the entry at the bottom of page 186 except the Notes Receivable Discounted account is credited for the face of the acceptance; the cash book entry to record the proceeds is the same as in the previous illustration.

June 14, 19...			
v	Cash	712 80	
	Interest Expense.....	5 75	
	Notes Rec. Discounted		718 55
	Discounted acceptance		
	No. 6.		

When these entries are posted, the Notes Receivable Discounted account will contain a credit for the face of each of the notes discounted and the face of each of these notes will remain as debits in the Notes Receivable account. This means that the debit balance of the Notes Receivable account does not show the amount to be collected because of written promises owned by the business because the cash has been received for the two notes discounted. The credit for the face of the two notes discounted is, however, recorded as a credit to the Notes Receivable Discounted account, hence the credit balance of the Notes Receivable Discounted account must be deducted from the debit balance of the Notes Receivable account in order to ascertain the amount of the asset notes receivable.

Contingent Liabilities on the Balance Sheet. When an account is maintained with Notes Receivable Discounted in order to record the contingent liability because of discounted notes, it is necessary to show on the Balance Sheet the balance of this account as a deduction from the balance of the Notes Receivable account. According to the information recorded in the notes receivable register on pages 190 and 191, the value of the notes receivable owned by Walker & Mills, June 30, is \$2,965.40. Assuming that a Notes Receivable Discounted account is maintained, the debit balance of the Notes Receivable account would be \$4,683.95 and the credit balance of the Notes Receivable Discounted account, \$1,718.55. The method of showing on the Balance Sheet the information re-

corded in these two ac-
counts is in the illustration at the right. You

Notes Receivable.....	4683 95	
Less Notes Rec. Discounted	1718 55	2965 40

will observe that the credit balance of the Notes Receivable Discounted account is shown as a deduction from the debit balance of the Notes Receivable account and that the amount of the notes receivable owned by Walker & Mills is the difference between the balance of the Notes Receivable account and the Notes Receivable Discounted account.

Removing a Contingent Liability from the Ledger. When the maker of a note receivable which has been discounted pays it at maturity, the contingent liability because of the indorsement is canceled. When this contingent liability has been recorded in the Notes Receivable Discounted account, it will be necessary to remove the contingent liability from the ledger. This requires an entry in the general journal in which the Notes Receivable Discounted account is debited for the face of the note paid and the Notes Receivable account credited for the same amount.

The journal entry in the illustration below shows the entry required in the general journal of Walker & Mills when trade acceptance No. 6, discounted at the bank June 14, is paid by the maker at maturity. No notice of protest

August 3, 19...				
Notes Receiv. Discounted	718 55			
Notes Receivable.....		718 55		
To cancel contingent liability on note receivable No. 6.				

received by Walker & Mills would indicate that the drawee of the draft has honored it at maturity, hence provides the authority for canceling the contingent liability. A

notice of protest indicates to the indorsee that the note receivable discounted has not been honored at maturity, hence the contingent liability should exist.

It is not necessary to record the contingent liability on notes receivable discounted because this information can always be obtained from an audit of the Notes Receivable account. Since the recording of a contingent liability requires an entry for which there may be no business form, it is customary to depend upon an audit of the Notes Receivable account for the desired information regarding contingent liabilities.

NOTES RECEIVABLE REGISTER

DATE RECEIVED	OUR NO.	MAKER NOTE	DRAWEE (DRAFT)	PAYEE AND ENDORSER	WHERE PAYABLE	PURPOSE
May 2	1	Wm. L. Brown			Bank of Troy	in full account
8	2	Wm. L. Brown			Bank of Troy	in full account
17	3	E. L. Marx		O. M. North	City Bank, Troy	Acct. of O. M. North
22	4	Wm. L. Brown			Bank of Troy	in full account
29	5	Wm. L. Brown			Bank of Troy	in full account
June 5	6	Wm. L. Brown			Bank of Troy	in full account
12	7	Wm. L. Brown			Bank of Troy	in full account
19	8	Wm. L. Brown			Bank of Troy	in full account

Illustration 47, Notes Receivable Register (Left Page)

Note Registers. The Notes Receivable account contains a record of the face of each note owned by the business and the Notes Payable account a record of the face of each note owed by the business; the term "note" used here includes acceptances and notes both receivable and payable. When the transactions with notes receivable and notes payable are numerous, it is customary to maintain a supplementary record of the notes in separate registers, one for notes receivable and one for notes payable. The title of each register indicates the nature of the notes recorded in it.

The ruling in each register provides for recording all the needed information regarding each note on one horizontal line; the various units of information desired are separated by vertical lines.

Notes Receivable Register. The purpose of this register is to contain a record of each note receivable received by the business. The information recorded in this register is (a) date of the transaction, (b) register number, (c) name of the maker of a note or the drawee of a draft, (d) name of the payee or indorser of a note or the name of the payee of a draft, (e) name and address of the bank at which the paper is payable, (f) purpose or reason for

NOTES PAYABLE REGISTER

DATE ISSUED	OUR NO.	PAYEE (NOTE)	DRAWER (DRAFT)	ADDRESS	WHERE PAYABLE	PURPOSE
May 5	1	Merchant's Bk. Co.		City	Merchant's Bk. Co.	Loan
12	2	Bank of Troy		Providence	Providence Bank	To purchase of goods
22	3	Wm. L. Brown		Providence	Providence Bank	In full account
29	4	Wm. L. Brown		Providence	Providence Bank	In full account
June 12	5	Wm. L. Brown		Chicago	Chicago Bank	In full account
19	6	Wm. L. Brown		Chicago	Chicago Bank	In full account
26	7	Wm. L. Brown		St. Paul	St. Paul Bank	To purchase of goods
30	8	Wm. L. Brown		Baltimore	Baltimore Bank	In full account

Illustration 48, Notes Payable Register (Left Page)

NOTES RECEIVABLE REGISTER

DATE OF PAPER			TIME	MATURITY	FACE VALUE	RATE OF INT	MATURITY VALUE	DATE COLLECTED	REMARKS
YEAR	MONTH	DAY							
19	May	1	90 days	July 30	500.00	5%	537.50		
19	May	8	60 days	July 7	100.00	—	102.55		
19	April	28	30 days	May 28	125.00	5%	129.25	May 28	
19	May	5	60 days	June 4	200.00	—	204.15	June 4	
19	May	5	60 days	June 4	500.00	5%	547.02		
19	June	1	60 days	August 1	7,500.00	—	7,575.00		Discounted June 1
19	May	15	60 days	July 14	627.65	—	627.65		
19	May	15	60 days	August 1	500.00	5%	500.00		Discounted June 1

Illustration 47, Notes Receivable Register (Right Page)

which the paper was received, (g) date of the paper, (h) time, (i) maturity date, (j) face, (k) rate of interest, if any, (l) maturity value, (m) date collected, and (n) disposition of the paper if sent for collection or discounted.

Each note receivable or acceptance receivable is recorded in the general journal and in this register at the time it is received. The register number is marked on the note and stated in the explanation of the general journal entry; the register number is not the number on the paper because this usually refers to the same number on the stub from which the paper was removed. The notes receivable register is ruled so that all the information may be recorded on one horizontal line with each unit of information separated by vertical lines. All the spaces separated by vertical lines are filled out at the time the paper is received except the two at the extreme right; the entries in these columns are made at the maturity of the paper or at the time it is sent to a collecting bank for collection or discounted:

The notes receivable register in Illustration 47 above and on page 190 contains a record of five notes and three acceptances received by Walker & Mills during the months of May and June. Nos. 6, 7 and 8 are illustrated on

NOTES PAYABLE REGISTER

DATE OF PAPER			TIME	MATURITY	FACE VALUE	RATE OF INT	MATURITY VALUE	DATE PAID	REMARKS
YEAR	MONTH	DAY							
19	May	5	30 days	June 4	1000.00	5%	1000.00	June 4	
19	May	10	60 days	July 9	327.65	—	327.65		
19	May	25	30 days	June 24	467.31	5%	469.72	June 24	
19	May	21	60 days	July 20	327.60	5%	330.88		
19	June	8	20 days	June 28	2194.7	—	2194.7	June 28	
19	June	15	60 days	August 14	1000.00	—	1000.00		Interest at 6% paid in advance
19	June	17	30 days	July 17	411.15	—	411.15		
19	June	20	60 days	August 19	300.00	5%	303.00		

Illustration 48, Notes Payable Register (Right Page)

pages 184, 185 and 186. A comparison of the information recorded in the register with the notes will provide further information regarding the method of registering each note or acceptance.

At the end of each month when a Trial Balance is prepared, the information in the note receivable register should be verified with the Notes Receivable account. The sum of the uncollected notes recorded in the notes receivable register should be the same as the balance of the Notes Receivable account. The balance of the Notes Receivable account on the ledger of Walker & Mills is \$2,965.40; the sum of the face of the notes that have not yet been collected is this same amount, hence the information recorded in the note register may be considered as correct.

Notes Payable Register. The purpose of this register is to contain a record of each note payable issued by the business. The information recorded in this register includes (a) date of the transaction, (b) register number, (c) payee or drawer and address, (d) name and address of the bank at which it is payable, (e) purpose for which the note was issued, (f) date of the note or acceptance, (g) time, (h) maturity, (i) face value, (j) rate of interest, if any, (k) maturity value, (l) date paid, and (m) remarks.

The ruling is the same as the notes receivable register in that it provides for full information regarding each paper to be recorded on one horizontal line and the separate units of information in spaces provided by vertical lines. When a note payable is signed or a draft accepted, it is recorded in the register and general journal before it is given to the payee, the collecting agent, or mailed to the payee; the register number is stated in the explanation of the general journal entry.

The notes payable register in Illustration 48 on pages 190 and 191 contains a record of the five notes and three acceptances issued by Walker & Mills during the months of May and June. Acceptances are distinguished from notes by indentation in the Payee column and trade acceptances are indicated by "T. A." in the Purpose column. Each note is recorded in the register at the time it is issued and each trade acceptance at the time it is reported accepted.

Sight drafts are usually not entered in the notes receivable or notes payable register. The stub from which the sight draft is removed is retained by the drawer as a record of the draft, hence it is not necessary to enter it in the notes receivable register. Sight drafts are honored if paid when presented, hence there is no purpose in entering them in the notes payable register.

REPORTS

Complete Reports Nos. 45 and 46 in the work book and present to the instructor for approval. Continue with the text discussion until Report No. 47 is required on page 198.

CHAPTER XVI

CLASSIFIED DEFERRED CHARGES

THE INSURANCE POLICY REGISTER

The discussion in this chapter provides a review of deferred assets explained and illustrated in Chapter VIII and additional information in regard to (a) the classification of supplies and insurance, (2) the accounts required when these are classified, (3) the insurance policy register, and (4) deferred credits to income.

Deferred Charges. Assets and services purchased for use in the business which will be consumed by their use within a short time are usually referred to as *deferred charges* or *deferred assets*. Deferred charges usually include *supplies* of various kinds and *prepaid services* such as insurance and prepaid interest on notes payable. You must keep in mind the fact that the term *deferred charges* describes a type of assets needed in the operations of the business but which will soon become expenses because the assets have been used. The expense involved in connection with the use of a deferred asset is the cost of the asset used.

Classification of Deferred Charges. Supplies consist of (a) wrapping paper, twine, and containers for use in the sale of merchandise, (b) gasoline, oil and similar material for use in maintaining the delivery equipment, (c) stationery, postage, catalogs, circulars, etc., for use in the office, and (d) fuel for heating purposes. All supplies may be recorded in one asset account or they may be classified and recorded in separate accounts, each account containing a record of the supplies purchased for a specific purpose. The usual plan is to classify them into the following groups: (a) store supplies, (b) delivery supplies, (c) office supplies, (d) postage, and (e) fuel.

Recording Deferred Charges. The purchase of supplies for cash is a transaction in which the asset supplies increases and the asset cash decreases. The purchase of supplies on credit is a transaction in which the asset supplies increases and the liability accounts payable increases. An account with the title Supplies or an account with a title descriptive of the supplies is debited for the cost price of the deferred charge at the time of purchase; the Cash account or Accounts Payable account is credited for the amount of the purchase. Thus, the debit for supplies purchased may be one account with Supplies or an account with the title Store Supplies, Delivery Supplies, Office Supplies, Postage or Fuel.

The balance of the one account with Supplies or the sum of the balances of the separate accounts with supplies is the cost of deferred charges made available for use during the fiscal period. The amount in either case is not usually an asset at the close of a fiscal period because the various types of supplies are purchased for use in the operations of the business and a greater part or all of them may have been used.

Recording the Deferred Charges Consumed. When one or more units of the asset deferred charges is used, its value becomes an expense. This expense may be recorded at the time the unit is used or the total expense because of all the units used may be recorded at the close of the fiscal period; the usual plan is to record the expense at the close of the fiscal period. To ascertain the expense because of deferred charges used, it is necessary to ascertain through taking stock the asset value of all the deferred charges or the asset value of each group of deferred charges.

The difference between the balance of the account to which the cost value of the deferred charges is debited and the inventory of the deferred charge is the expense because of supplies used during the fiscal period. Thus, if the Postage account shows a debit of \$200.00 at the close of the fiscal period and a count of the stamps on hand shows only \$50.00, it is quite evident that \$150.00 worth of stamps have been used and that this is an expense.

When separate accounts are maintained with each type of supplies, the method of adjustment is the same as when only one account is maintained except it is necessary to make as many entries as there are separate types of supplies accounts. An expense account with the title of the type of supplies and including the word "Used" is debited and each supplies account credited for the difference between the balance of the account and the inventory of each type of supplies.

Illustrations. The accounts in the illustration at the right below and at the top of page 195 appear on the ledger of Walker & Mills, the retail merchants referred to in the preceding chapter, June 30. You will observe that there are five accounts, Store Supplies, Delivery Supplies, Office Supplies, Postage and Fuel. These accounts indicate that supplies of the nature described by the title of each account are required and the cost of each type is debited to the account at the time it is purchased.

STORE SUPPLIES									
19 June	1	Inv.	✓	86 40					
	16		P 29	51 65					
DELIVERY SUPPLIES									
19 June	1	Inv.	✓	22 50					
	5		C 17	12 50					
	25		C 19	20 —					
OFFICE SUPPLIES									
19 June	1	Inv.	✓	62 50					
	5		P 27	15 75					

Total Purchases, Postage	\$178.50
Postage on hand.....	79.48
Value of Postage Used.....	\$ 99.02
Total Purchases, Fuel.....	\$ 36.25
Fuel on hand.....	36.25
Value of Fuel Used	\$ 0.00

The illustration at the right below shows the method of recording the expense because of supplies consumed during the fiscal period. You will observe that in each case the debit and credit is the difference between the balance of the supplies account and the supplies inventory. The debit in each case records a decrease in proprietorship of the nature described by the title and the credit in each case records the decrease in assets of the type described by the title. The fuel inventory is the same as that on hand at the beginning of the month because no fuel was needed to heat the store during June, hence no expense is involved.

June 30, 19...

Store Supplies Used.....	75 55		
Delivery Supplies Used.....	30 35		
Office Supplies Used.....	26 90		
Postage Used.....	99 02		
Store Supplies.....		75 55	
Delivery Supplies.....		30 35	
Office Supplies.....		26 90	
Postage.....		99 02	
To record the cost of supplies and postage used.			

The accounts in the illustration at the left and on page 197 show the results of posting the above journal entry to the accounts on pages 194 and 195. The first five are asset accounts and the next four, expense accounts. The asset accounts are balanced and the inventory carried down under date of the first day of the next fiscal period. The Fuel account is not balanced because no fuel is consumed; the inventory and the account balance at the beginning of the fiscal period are the same.

STORE SUPPLIES									
19 June	1	Inv.	√	86 40	19 June	30	Inv.	J 7	75 55
	16		P 29	51 65		30		√	62 50
				138 05					138 05
July	1	Inv.	√	62 50					
DELIVERY SUPPLIES									
19 June	1	Inv.	√	22 50	19 June	30	Inv.	7	30 35
	5		C 17	12 50		30		√	24 65
	25		C 19	20 —					
				55 —					55 —
July	1	Inv.	√	24 65					

FUEL

DELIVERY SUPPLIES USED

OFFICE SUPPLIES USED

POSTAGE USED

The balance of each expense account is shown on the Profit and Loss Statement as an expense. The accounts are arranged in the ledger in the order in which they should appear on the Profit and Loss Statement to provide the desired classification of expenses.

When the ledger is closed, the balance of each of the four expense accounts will be transferred to the Profit and Loss Summary account because each is a decrease in proprietorship. As ex-

plained in the note on page 92, it is not necessary to open the expense accounts in the ledger as these can be posted direct to the Profit and Loss Summary account when posting the adjusting entries.

Deferred Charges as Expenses. Some accountants record deferred charges as expenses at the time of purchase. When this plan is followed, it will be necessary at the close of the fiscal period to take out of the expense accounts the debit balances of which show the cost of deferred charges the asset value of the deferred charges not yet used. Thus, office supplies purchased are debited to an expense account with the title Office Supplies. At the close of the fiscal period the debit balance of the Office Supplies account is \$350.00. At the close of the fiscal period the inventory of office supplies is \$100.00. An account

with Deferred Charges is debited for \$100.00 and the account with Office Supplies credited for the same amount. When this entry is posted, the asset value of the deferred charges, that is, office supplies not used, is recorded as a debit to the Deferred Charges account and as a credit to the Office Supplies account; the balance of the Office Supplies account will then show the \$250.00 expense because of office supplies used during the fiscal period.

REPORTS

Complete Report No. 47 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 48 is required on page 204.

Insurance. The protection against loss because of destruction by fire or other natural causes is referred to as insurance. This protection is provided by insurance companies. The contract in which the insurance company agrees to pay the owner of the property for loss is referred to as the *policy* and the amount the owner pays the insurance company for this protection, as the *premium*. The premium is usually stated as a rate per thousand dollars of insurance for one year. This rate is fixed by a board of underwriters composed of representatives of insurance companies, and is based on the nature of the property and its location.

Annual and Term Insurance. When the rate applies to insurance for twelve months, it is known as the *annual rate* and the insurance, as *annual insurance*; when the rate applies to insurance for a longer period, it is known as the *term rate* and the insurance, as *term insurance*. Merchandise in stock and other property the value of which is constantly changing will ordinarily be insured for not more than one year. Buildings, furniture, and other property the value of which is less likely to change may be insured for one year or for a longer term such as three or five years.

The term rate is somewhat cheaper than the annual rate since the insurance company is saved the expense of reinsuring the property each year. A policy for

INSURANCE POLICY REGISTER

DATE OF POLICY	No.	NAME OF COMPANY	PROPERTY INSURED	AMOUNT	TIME	PREMIUM
July 1	623712	U.S. Fire Insurance Co.	Merchandise	1000	1 yr.	75.50
July 1	623718	U.S. Fire Insurance Co.	Household equipment	1000	1 yr.	18.80
July 1	774116	Automobile Mutual	Household equipment	500	1 yr.	25.25
Aug. 1	278001	U.S. Fire Insurance Co.	Household equipment	2000	3 yrs.	59.40
Oct. 1	623731	U.S. Fire Insurance Co.	Merchandise	2500	1 yr.	25.50
Nov. 1	733115	U.S. Fire Insurance Co.	Merchandise	5000	1 yr.	51.00
Apr. 1	846222	U.S. Fire Insurance Co.	Merchandise	3000	1 yr.	30.30
Apr. 1	846223	U.S. Fire Insurance Co.	Merchandise	10000	1 yr.	102.00
June 1	946117	Automobile Mutual	Household equipment	3000	1 yr.	27.30

Illustration 49, Insurance Policy Register (Left Page)

\$10,000.00 issued on merchandise with an annual rate of \$16.75 per year requires the payment of \$167.50 premium at the time the policy is issued. A policy of \$20,000.00 issued on a building with a term rate of \$25.00 for five years requires the payment of \$500.00 at the time the policy is issued. The insurance on merchandise will expire twelve months from the date of the policy. The insurance on the building will expire five years from the date of the policy.

Canceled Insurance. The insured has the privilege of canceling an insurance policy at any time before its expiration. Should the insured elect to cancel a policy, he will receive a refund from the insurance company for that part of the premium which has not expired. When insurance is canceled, the expired portion is assigned a higher rate than that stated in the policy, hence the refund received from the insurance company will be less than the book value of the unexpired insurance. The Board of Underwriters fixes the *short time* rate applicable to expired insurance when a policy is canceled.

Insurance Policy Register. Each insurance policy contains the following information in regard to the policy, (a) date, (b) serial number, (c) name of the insurance company, (d) description of the property insured, (e) amount of the insurance, (f) time of the policy, and (g) amount of the premium. The insurance policy register is a book ruled to contain a summary of the information in each insurance policy. Its purpose is to provide a convenient means for ascertaining (a) the amount of insurance carried, (b) the asset value of prepaid insurance at the close of the fiscal period and (c) the amount of the expense because of expired insurance. The register may be a card for each policy or a ruled blank for recording all the desired facts regarding each policy on one horizontal line; the ruled blank is more convenient especially when ascertaining the total unexpired at the close of the fiscal period.

Illustration 49 at the bottom of page 198 and below contains a record of the seven insurance policies in the safe of Walker & Mills at the close of the fiscal period, June 30. The information in this register was recorded at

INSURANCE POLICY REGISTER

JULY	AUG.	SEPT.	OCT.	NOV.	DEC.	JAN.	FEB.	MAR.	APR.	MAY	JUNE	EXPIRED	UNEXPIRED
8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50				7650	
3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3960	7920
22.75	22.75	22.75	22.75	22.75	22.75	22.75	22.75	22.75	22.75	22.75		25025	
⁵ / ₁₆ 1.65	⁵ / ₁₆ 1.65	⁵ / ₁₆ 1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1815	4125
			² / ₁₃ 2.13	2.13	2.13	2.13	2.13	2.13	2.13	2.13	2.13	1417	633
				⁴ / ₂₅ 2.5	⁴ / ₂₅ 2.5	⁴ / ₂₅ 2.5	⁴ / ₂₅ 2.5	⁴ / ₂₅ 2.5	4.25	4.25	4.25	34	17
									2.55	2.55	2.55	765	2295
									⁸ / ₅ 1.3	⁸ / ₅ 1.3	8.50	2550	7650
											²² / ₅ 7.5	2275	⁴⁹ / ₅ 9.8

Illustration 49, Insurance Policy Register (Right Page)

the time each policy was received from the insurance company. Referring to the illustration, you will observe that all the information in regard to each policy is recorded on one horizontal line; the columns at the right, through vertical lines for the various units of information, show the expired insurance for each fiscal period. The register illustrated is ruled for monthly fiscal periods. Whether the length of the fiscal periods is one month, three months, six months, or a year, a column is provided for each fiscal period and the amount of the expired insurance for the fiscal period recorded in the column on a line with each policy.

Insurance Expense. When the insurance premium is paid, the transaction results in an exchange of one asset for another, that is, the asset cash is given for the asset prepaid insurance. Since the insurance policy is a contract agreeing to provide protection for a stated time, it is quite evident that the asset prepaid insurance will decrease in value day by day. This is made clear in the discussion on page 93.

The decrease in the asset prepaid insurance results in a corresponding decrease in proprietorship, that is, an expense known as insurance expense. The proprietor of a business may be satisfied with knowing the expense in one amount because of expired insurance or he may wish to know the amount of the expense applicable to each class of property insured. Thus, if a merchant owns the building used as a home for the business and maintains delivery equipment for delivering goods, it is quite evident that he would like to know the insurance expense applicable to (a) the building, (b) the stock of merchandise, and (c) the delivery equipment; this information is of more value than the total insurance expense as shown by the balance of one account.

Recording Expired Insurance. The expense because of expired insurance premiums may be recorded daily but is usually recorded only at the close of the fiscal period. This expense may be recorded in one account with the title Expired Insurance or in separate accounts each of which contains a description of the property insured. Thus, the expired insurance premium on office equipment, store equipment, and merchandise may be recorded in one account with the title Expired Insurance or in three accounts with the title Expired Insurance on Office Equipment, Expired Insurance on Store Equipment, and Expired Insurance on Merchandise.

Illustration. The account in the illustration at the right appears on the ledger of Walker & Mills, the merchants referred to in this and the preceding chapter, at the close of the fiscal period June 30. You will observe that the debit balance of this account is the total prepaid insurance; it includes the asset value of the insurance at the beginning of the June fiscal period and the amounts paid as insurance premiums during the period; see insurance policy register, pages 198 and

PREPAID INSURANCE									
19									
June	1	Unexp	✓	265	61				
	1	C	17	273	—				

199. The balance of this account, however, is not an asset because of the expired insurance. It is desired at the close of the June fiscal period to record in the ledger through an entry in the general journal the expense because of expired insurance and to show this expense applicable to each kind of property.

The entry in the illustration at the left is to record the insurance expense of Walker & Mills for the June fiscal period. The information for the debits in each entry is ascertained from the Property Insured and Premium columns in the insurance

June 30, 19			
Expired Ins. on Mdse.	17	43	
Exp. Ins. on Del. Equip.	22	75	
Exp. Ins. on St. & Of. Eq.	4	95	
Prepaid Insurance.			45 13
To record the expired insurance for June.			

register, pages 198 and 199. In each case the amount debited is the difference between the premium and the asset value of the premium June 30.

After the general journal is posted the Prepaid and Expired Insurance accounts will appear as in the illustration at the right. The Prepaid Insurance account is credited for the total expired insurance and each type of expense account is debited. The Prepaid Insurance account is balanced and the balance carried down on the debit side to show the asset value of prepaid insurance at the beginning of the July fiscal period. This balance should agree with the information in the insurance policy register; the sum of the Premium column less the sum of the Expired Insurance column for the fiscal period should be the balance of the Prepaid Insurance account at the beginning of the period.

The expense items may be posted direct to the Profit and Loss Summary account when posting the adjusting entry, in which case it is not necessary to open the expired insurance accounts.

Prepaid Interest on Notes Payable. When the interest on a note payable is paid in advance, the interest is for the use of the money for the full time of the note. If the maturity of the note is in a subsequent fiscal period, the amount debited to the Interest Expense account for the interest paid will be in excess of the interest applicable to the current fiscal period because the money has not yet been used for the full time of the loan. The expense for a current fiscal period should include only that incurred during the fiscal period.

PREPAID INSURANCE									
19						19			
June	1	Unexp	√	265	61	June	30	Unexp	J 7
	1		C 17	273	—		30		√
				538	61				493 48
									538 61
July	1	Unexp	√	493	48				

EXPIRED INSURANCE ON MERCHANDISE									
19									
June	30		J 7	17	43				

EXPIRED INSURANCE ON DELIVERY EQUIPMENT									
19									
June	30		J 7	22	75				

EXPIRED INSURANCE ON STORE AND OFFICE EQUIP.									
19									
June	30		J 7	4	95				

When a part of the interest expense incurred during a fiscal period is applicable to another fiscal period, the amount not consumed at the close of the fiscal period is an asset referred to as prepaid interest on notes payable. The asset value of prepaid interest on notes payable decreases the interest expense for the period the amount of the asset. This effect on assets and expense is recorded as a debit to an account with the title Prepaid Interest on Notes Payable and a credit to the Interest Expense account.

Recording Prepaid Interest on Notes Payable. June 15, Walker & Mills, the firm referred to in this and the preceding chapter, borrowed \$4,000.00 from the bank on their 60-day non-interest-bearing note, rate 6%. This means that Walker & Mills paid the bank \$40.00 for the use of the \$4,000.00 for 60 days and the transaction is recorded as a debit to the Interest Expense account and a credit to the Cash account.

It is quite evident that the debit balance of the Interest Expense account June 30, the close of the monthly fiscal period, is not all an expense because the \$40.00 has been used only 15 days while the interest has been paid for 60 days. In other words, one-fourth of the \$40.00 or \$10.00 is interest expense and three-fourths or \$30.00 is the asset prepaid interest on notes payable.

The entry in the illustration at the right is to take the \$30.00 out of the Interest Expense account and place it in the Prepaid Interest on Notes Payable account. Since the conditions stated reduce the amount of the interest expense applicable to the current

fiscal period, the Interest Expense account is credited. When this entry is posted, the debit balance of the Interest Expense account will be reduced \$30.00 through the entry on the credit side and the asset prepaid interest on notes payable will be recorded as a debit to the Prepaid interest on Notes Payable account.

June 30, 19			
	Prep. Int. on Notes Pay.	30	
	Interest Expense.....		30
	To record the prepaid interest on notes payable.		

Deferred Credits to Income. An increase in assets in excess of the decrease in assets resulting from an exchange of assets in a transaction is referred to as income. The income is usually recorded at the time the exchange in assets is made. Income may result from receiving an asset for a service, hence does not always involve an exchange of assets. The income reported on the Profit and Loss Statement as earned during the fiscal period should include only the income that is earned. If an asset is received for a service to be rendered in the future and all the service has not been rendered at the close of the fiscal period, it is quite evident that all the income recorded is not income applicable to the fiscal period.

September 1, Central School of Commerce receives \$2,400.00 for six months tuition paid in advance. This means that the students who paid this tuition have the privilege of attending the school and securing the services which it renders, for a period of six months ending with the last day of February

following. If the fiscal period of the school ended December 31, it is quite evident that all this tuition could not be regarded by the school as income for the period because it has yet to render two months or one-third of the service for which the students have paid.

Recording Deferred Credits to Income. When the increase in assets and increase in income is recorded in one fiscal period but all the income is not earned until a subsequent fiscal period, the unearned part at the close of the fiscal period is referred to as *deferred credits to income*. Thus, in the case illustrated, the school could include as income for the year only two-thirds of the amount received or \$1,600.00. The other one-third or \$800.00 will be earned in January and February which is in a subsequent fiscal period.

The entry in the illustration at the right would appear in the general journal of the school at the close of the fiscal period December 31. It is desired through this journal entry to subtract \$800.00 from the tuition income and to record it as a liability of the school to the students. The debit to the Tuition Income account records the decrease in the income for the fiscal period and the credit to the Deferred Credits to Income account records the increase in liabilities. Of course, the school does not

owe \$800.00 which the students will collect but it does owe this amount of service which it has not yet earned and unless the ad-

December 31, 19			
	Tuition Income	800	—
	Defer. Credits to Income		800
	To record the liability because of unearned tuition.		—

justing entry is made, the earnings for the period will be overstated. The management of the school is interested in knowing the income earned in each fiscal period, hence it is necessary to determine from the records the amount of unearned tuition at the close of each fiscal period and to record it as a liability and a deduction from the balance of the Tuition Income account.

Deferred credits to income are of importance to banks, magazine publishers, newspaper publishers, advertising agencies, and similar types of business where income is recorded some months in advance of its being earned. As in the case of a school, it is necessary for the management of each of the type of business mentioned to determine from the records the income recorded but not earned and to record that which is not earned as a liability and a deduction from the recorded income.

Account or Accounts with Supplies. The purpose of the one account with supplies or the separate accounts is to record the changes in the asset supplies. The Supplies account or each separate account is *debited* for increases and *credited* at the close of the fiscal period for the decreases due to use during the period. The *debit* balance of the one Supplies account or each of the separate supplies accounts at the close of the fiscal period before the adjusting entries are recorded shows the total cost of supplies purchased and made available for use; after adjustment, it shows the asset value of supplies on hand.

Supplies Used Account or Accounts. The purpose of the one account with Supplies Used or the separate accounts when supplies are classified is to show the expense because of the supplies used during the fiscal period. The one Supplies Used account or each separate account is *debited* for the decreases in proprietorship resulting from the cost of supplies used; there are usually no *credits*. The *debit* balance of the one Supplies Used account or the various accounts is an expense and is closed into the Profit and Loss Summary account.

Prepaid Insurance Account. The purpose of this account is to contain a record of the changes in the asset prepaid insurance no matter what the nature of the property insured may be. The Prepaid Insurance account is *debited* for premiums paid, and *credited* at the close of the fiscal period for decreases, that is, insurance expired during the period. The *debit* balance of the Prepaid Insurance account before it is adjusted shows the total amount of premiums paid during the fiscal period and after it is adjusted, the asset value of the unexpired insurance at the beginning of the next fiscal period.

Insurance Expense Account or Accounts. The purpose of the one expense account or each separate expense account is to show at the close of the fiscal period the amount of insurance expired during the period. The one account or each separate account is *debited* for the expired insurance; there are usually no *credits*. The *debit* balance of the one insurance expense account or the several insurance expense accounts is an expense and closed into the Profit and Loss Summary account.

Prepaid Interest on Notes Payable Account. The purpose of this account is to contain a record of the asset prepaid interest on notes payable. It is *debited* for the interest prepaid on notes payable at the close of the fiscal period. The debit balance of this account is usually transferred to the Interest Expense account at the beginning of the next fiscal period.

Deferred Credits to Income Account. The purpose of this account is to record the liability because of income collected in one period but not all earned within the period. This account is the amount recorded at the close of the fiscal period and *debited* for decreases; there are usually no *debits* except to transfer the balance at the beginning of the fiscal period.

REPORTS

Complete Report No. 48 in the work book and present to the instructor for approval. Continue with the text discussion until Report No. 49 is required on page 208.

CHAPTER XVII

CLASSIFIED FIXED ASSETS AND RESERVES

FIXED ASSET REGISTER

The method of recording equipment when purchased and the expense because of depreciation at the close of the fiscal period is explained in Chapter VIII. The discussion in this chapter provides a review of Chapter VIII and additional information regarding (1) classified fixed assets, (2) fixed asset register, and (3) reserves applicable to fixed assets and accounts receivable.

Classification of Fixed Assets. Assets purchased for use in the business which will be of service for a number of fiscal periods and which may not be entirely consumed through use are usually referred to as *equipment* or *fixed assets*. Fixed assets are usually classified according to the purpose for which they are used. The usual purposes are as follows:

(1) Shelving, display cases, scales, two-wheel trucks, four-wheel trucks, lift trucks, and similar types of equipment used in the store room.

(2) Automobile trucks, delivery cars and in some cases horses and wagons used for delivering the merchandise sold.

(3) Office desks, typewriters, adding machines and other appliances, filing cases and equipment of similar type required for use in the office.

When the cost of an article is small and it may be necessary to replace it frequently, the amount is recorded as an expense at the time the article is purchased. Thus, the cost of a desk is recorded as one of the fixed assets of the business but the cost of a waste paper basket, inkwells, rulers and similar small articles is usually recorded as an expense.

Recording Fixed Assets. When equipment is purchased, the cost price may be debited to one account with the title Equipment or to separate accounts with descriptive titles. The amount invested in fixed assets and the information needed regarding the expense because of depreciation will determine the account or accounts required because of fixed assets owned. In a mercantile business, the titles of the accounts required to record fixed assets are *Store Equipment*, *Delivery Equipment* and *Office Equipment*.

The titles suggested are not required. Thus, the cost of fixed assets used in the store room may be recorded in an account with the title *Shelving*, *Display Cases*, or *Store Room Fixtures*. Fixed assets purchased for use in delivering goods may be recorded in an account with the title *Delivery Trucks* or *Automobile Trucks*. Fixed assets purchased for use in the office may be recorded in an account with the title *Office Furniture*, *Office Furniture and Finishings*, or *Office Furniture and Fixtures*.

Keep in mind the fact that the purpose of the one account or the separate accounts with Equipment is to provide information regarding the amount invested in the equipment. Before reporting this amount to the owner on the Balance Sheet the accountant should verify his records by a count of the fixed assets. The inventory of fixed assets should agree with the balance of the one Equipment account or with the sum of the balances of all the equipment accounts.

Depreciation. The decrease in value of equipment through its use is known in accounting as *depreciation*. When an asset decreases in value without a corresponding increase in some other asset, the proprietorship decreases the same amount; this decrease in proprietorship is an expense, hence depreciation is an expense.

The exact amount of depreciation applicable to a given fixed asset can not be known until the fixed asset is sold, exchanged or discarded. When a fixed asset is sold or exchanged, the depreciation is the difference between the sale or exchange value and the original cost. When a fixed asset is discarded, the depreciation is the full amount of the cost. The expense because of depreciation is usually estimated at the close of the fiscal period and recorded as an expense for the period; any discrepancy between the estimated and actual depreciation is recorded at the time the fixed asset is sold, exchanged or discarded.

There are a number of methods used to ascertain the estimated depreciation. The usual method is to base the depreciation on the estimated number of years the asset will be of service. Thus, if it is estimated that a fixed asset will be of service for five years and at the end of that time will have no value, the depreciation for each yearly fiscal period is one-fifth or 20% of the cost.

Scrap Value. The nature of some fixed assets is such that they will have an exchange or trade-in value after they have been used in the operations of the business for a period of time; this value is referred to as *scrap* or *trade-in value*. The estimated depreciation of a fixed asset with a trade-in value is a per cent of the cost. When the depreciation to be recorded at the close of each fiscal period is estimated, the trade-in value must be considered. Thus, if a typewriter which costs \$125.00 has a trade-in value of \$25.00 at the end of the fourth year, the depreciation for each year is 20% of the cost or \$25.00. The typewriter costs \$125.00 but since it has a trade-in value, the amount to be charged off as depreciation is not the full cost but the full cost less \$25.00 or \$100.00. If \$100.00 is to be recorded as depreciation over a period of four years, it is quite evident that \$25.00 must be recorded at the end of each year. Since \$25.00 is one-fifth of the cost, \$125.00, and is 20% of the cost price, \$125.00, the annual depreciation rate is 20%.

The foregoing illustration serves to show one method of ascertaining the estimated depreciation applicable to fixed assets with a scrap value. The method of estimating depreciation does not affect the method of recording the expense

because of depreciation. Since accounting relates to providing information through account balances, the method used for ascertaining the estimated depreciation will not affect the method of recording the desired facts.

Recording Depreciation. It is customary to record the estimated expense because of depreciation on fixed assets at the close of each fiscal period. This estimated expense could be recorded daily but since the information is not needed until the close of the fiscal period it is more economical to record it at that time.

When the cost of all fixed assets is recorded in one account, the expense because of depreciation is debited to one expense account with the title Depreciation Expense. When the cost of the fixed assets in each group is recorded in an account with a title descriptive of the asset, a separate expense account with a descriptive title is required to record the depreciation applicable to each group. Whether the depreciation is debited to one expense account or to separate accounts, the corresponding credit is to a depreciation reserve account; a separate depreciation reserve account is provided for each group of fixed assets.

From this discussion it will be observed that three accounts are required with each group of fixed assets as follows:

- (1) Store Equipment
- (2) Depreciation Reserve for Store Equipment
- (3) Depreciation on Store Equipment
- (1) Delivery Equipment
- (2) Depreciation Reserve for Delivery Equipment
- (3) Depreciation on Delivery Equipment
- (1) Office Equipment
- (2) Depreciation Reserve for Office Equipment
- (3) Depreciation on Office Equipment

The first two accounts in each group record the change in the fixed asset because of depreciation and the third account in each group, the expense because of this depreciation. The balances of the first two accounts in each group and the book value of each group of fixed assets are shown on the Balance Sheet. The balance of the expense account which records the estimated depreciation is shown on the Profit and Loss Statement.

Illustration. The method of recording depreciation expense when the fixed assets are grouped and recorded in separate accounts is further explained by illustration. This illustration applies to the June fiscal period of Walker & Mills. The estimated depreciation on the fixed assets at the close of the June fiscal period is as follows:

Store Equipment	\$10.00
Delivery Equipment	\$50.00
Office Equipment	\$26.51

The depreciation on office equipment is the sum of the amounts in the June fiscal period column of the fixed asset register, Illustration 50, pages 210 and 211; the information regarding the depreciation on store equipment and delivery equipment is contained in the June column on the page of the fixed asset register for each class of fixed asset. The one illustration of the fixed asset register is sufficient to illustrate the use of this book. The depreciation on store equipment and delivery equipment is obtained from the records in the same manner as the depreciation on office equipment, and is not an arbitrary amount provided for the purpose.

The general journal entry in the illustration at the right records the depreciation for the June fiscal period in the accounts suggested on page 207. When the entry is posted, the amount of the expense because of depreciation during the June fiscal period will be debited to the appropriate expense account and the estimated decrease in value of the fixed assets will be credited to the appropriate reserve account. If all the fixed assets owned by Walker & Mills had been recorded in one account with Equipment, the journal entry would have contained only one debit and one credit, the amount in each case being the sum of the three debits and the three credits.

June 30,19			
	Depr. on Store Equipment	10 --	
	Depr. on Del. Equipment	50 --	
	Depr. on Office Equipment	26 51	
	Depr. Res. for St. Eq.		10 --
	Depr. Res. for Del. Eq.		50 --
	Depr. Res. for Of. Eq.		26 51
To record the depreciation on store, delivery and office equipment.			

If desired, one account with Depreciation Expense may be opened in the ledger and the three debits posted to this account in separate amounts with the title of the equipment to which the depreciation applies written in the explanation column. The separate accounts are more desirable because each has a different classification, hence would be in a separate division of the ledger.

Fixed Asset Register. This register contains a record of each fixed asset owned by the business. The purpose of the fixed asset register is to provide (a) a record of the fixed assets, (b) a convenient means of ascertaining at the close of each fiscal period the expense because of depreciation and (c) the book value of each fixed asset. The title *fixed asset register* is descriptive of its purpose, that is, a record of the fixed assets which agrees with each fixed asset and depreciation reserve account.

The information recorded in a fixed asset register is a detailed description of each fixed asset. It includes (a) date of purchase, (b) identification number, (c) description of the property, (d) purchase price, (e) estimated scrap value, (f) number of years it is estimated the fixed asset may be used, and (g) annual rate per cent of depreciation. The information in regard to any one fixed asset is recorded on one horizontal line in the fixed asset register

at the time the fixed asset is purchased; various units of information are separated by vertical lines.

In order that the fixed asset register may contain a record of the book value of each fixed asset, also provide a convenient means for ascertaining at the close of each fiscal period the expense because of depreciation, a column is provided for depreciation during each fiscal period. At the close of the fiscal period, the amount of depreciation applicable to each fixed asset is entered in the column and on a line with the fixed asset; the total of the amounts entered in the depreciation column at the close of the fiscal period is the total expense because of depreciation during the period. The book value of each fixed asset is the cost value less the sum of the amounts recorded in the depreciation columns on a line with it.

The fixed asset register in Illustration 50 on pages 210 and 211 contains a record of the office equipment owned by Walker & Mills. Full information regarding each fixed asset is recorded on one horizontal line. This includes the date of purchase, identification number, description, cost, scrap value if any, number of years the asset will be of service, annual rate of depreciation and columns for the amount of depreciation for each fiscal period.

The firm operates on a monthly fiscal period basis, hence each of the twelve columns provided for depreciation cover a period of one month. Since the firm began business on January 1, the total depreciation recorded during the first year or fraction of a year is recorded in the Amount column at the extreme right of the left hand page. The amount of depreciation recorded in each of the six depreciation columns is that applicable to the first half of the second year, that is, the first six fiscal periods in the second year. Each amount recorded in the June fiscal period column is the depreciation applicable to the fixed asset described on the line with it for the fiscal period of June. The book value of each fixed asset is the difference between the cost and the sum of the amounts in the depreciation columns on a line with the cost. The total depreciation on office equipment for June is the sum of the amounts in the June column.

The fixed asset register illustrated contains a record of the equipment used in the office. The equipment used in the store room and delivery department will be recorded on separate pages.

If desired, a record of each unit of equipment may be kept on a separate card, in which case the information in the file containing these cards will be the same as that recorded in the fixed asset register.

Expense in Connection with Fixed Assets. The ownership of fixed assets results in four types of expense (a) depreciation, (b) expired insurance, (c) property taxes, and (d) repairs. Depreciation, insurance and property taxes are usually recorded at the close of the fiscal period; repair cost is usually recorded in an account with the title Repairs on Fixed Assets at the time the repairs are paid.

Depreciation expense and expired insurance are recorded at the close of the fiscal period because it is more economical to record these expenses at that

FIXED ASSETS REGISTER OFFICE EQUIPMENT

DATE	NO.	DESCRIPTION	COST	SCRAP VALUE	NO. OF YEARS	RATE	DEPRECIATION	
							YEAR	AMOUNT
Jan 2	101	W-Typewriter 16421-5	125-	25-	4	20%	1 yr.	25-
	2	Typewriter Desk	75-		10	10%	1 yr.	750
	2	Typewriter Chair	30-		5	20%	1 yr.	6-
	2	Office Desk	96-		10	10%	1 yr.	960
	2	Office Chair	30-		5	20%	1 yr.	6-
July 1	106	Adding Machine	150-	25-	5	16 2/3%	3 mos.	1250
Oct 1	107	Adding Machine	300-		5	16 2/3%	3 mos.	1250
Dec 1	108	Filing Cases	81 60		10	10%	1 mo.	79 78
Jan 1	109	Duplicating Machine	125-		5	20%		
Feb 1	110	Dictating Machine	300-	50-	5	16 2/3%		
April 1	111	Bookkeeping Machine	625-	125-	5	16%		
May 1	112	Book Case	20 62 40		10	10%		

Illustration 50, Fixed Asset Register (Left Page)

time than to record them daily. Property taxes may be recorded at the time the taxes are paid but since the tax day and the close of the fiscal period are seldom the same, it is usually customary to record the property taxes at the close of the fiscal period and to adjust this record at the time the taxes are paid. This will be explained in a subsequent chapter.

Capital and Revenue Expenditures. These terms are used in accounting to distinguish between the cost of a fixed asset and the expense required to maintain its usefulness. Thus, the purchase of a delivery truck is a *capital expenditure* and the purchase of a new tire or part to replace an old one, a *revenue expenditure*. The cost of a new body in order to make the truck more serviceable is a capital expenditure because it increases the cost of the truck.

Capital expenditures are recorded as assets in the appropriate asset account at the time of purchase; revenue expenditures are recorded as expenses in the appropriate expense accounts at the time the expenditures are made. A capital expenditure becomes an expense through recording estimated depreciation at the close of each fiscal period; a revenue expense is an expense at the time it is incurred. The only reason capital expenditures are recorded as assets is because they will not ordinarily be consumed within one fiscal period, hence the expense because of their decrease in value is applicable to a number of periods.

Disposition of Fixed Assets. When a fixed asset has served its purpose, it will be exchanged, sold or discarded. When disposed of in the manner suggested, the book value of the fixed asset must be removed from the ledger through an entry in the general journal in which the fixed asset account is credited with the cost and the depreciation reserve account debited with the

FIXED ASSETS REGISTER—OFFICE EQUIPMENT

JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.	CARRIED FORWARD	DISPOSITION
2.08	2.08	2.08	2.08	2.08	2.08								
.62	.62	.62	.62	.62	.62								
.50	.50	.50	.50	.50	.50								
.80	.80	.80	.80	.80	.80								
.50	.50	.50	.50	.50	.50								
2.08	2.08	2.08	2.08	2.08	2.08								
.68	.68	.68	.68	.68	.68								
2.08	2.08	2.08	2.08	2.08	2.08								
.68	.68	.68	.68	.68	.68								
2.08	2.08	2.08	2.08	2.08	2.08								
17.66	17.66			8.33	8.33								
				25.99	52.52								

Illustration 50, Fixed Asset Register (Right Page)

recorded depreciation applicable to the fixed assets. The recorded depreciation applicable to a fixed asset is the sum of the depreciation recorded on a line with its cost in the fixed asset register.

Keep in mind the fact that depreciation as recorded in a depreciation reserve account is only estimated and that this may be more or less than the actual depreciation at the time the fixed asset is sold. The point to be emphasized in accounting is that the recorded depreciation must be removed from the depreciation reserve account and the cost price of the asset from the fixed asset account. Any over or under estimation of the expense will be adjusted through an expense or an income account with a title descriptive of its meaning.

May 1. Walker & Mills purchased a new motor truck for \$1,250.00. Gave in payment a check for \$825.00 and a used truck, cost value \$800.00, book value \$500.00, exchange value \$425.00.

The general journal entry at the left and the cash book entry on page 212 record this transaction. The Delivery Equipment account is debited to

record the cost of the new truck and credited to record the cost of the truck exchanged. The Depreciation Reserve for Delivery Equipment account is debited for the amount of recorded depreciation applicable to the

May 1, 19	
Delivery Equipment.....	1250—
Depr. Res. for Del. Equip.	300—
Loss on Exch. of Fix. Assets	75—
Delivery Equipment.....	
Cash.....	800—
Exchanged truck No. 96 for new truck No. 181.	825—

truck exchanged. An account with the title Loss on Exchange of Fixed Assets is debited for \$75.00, the difference between the book value, \$500.00, and the exchange value, \$425.00. The Cash account is credited for the amount of the check issued. Check marks are used to avoid double posting.

CASH				Payments	
19 May	1	√	Delivery Equipment	Truck exchanged	825—

When the general journal entry is posted, the cost value of the new truck will be recorded on the debit side of the Delivery Equipment account, the cost of the exchanged truck and the recorded depreciation on it will have been taken out of the equipment and reserve accounts and the decrease in proprietorship resulting from the exchange will be recorded on the debit side of an account with a descriptive title. When the total of the cash book is posted at the end of the month, the amount of the cash paid will be recorded on the credit side of the Cash account. In other words, all previous entries affecting the purchase and depreciation of the exchanged truck will be canceled and the cost value of the new truck will appear on the debit side of the Delivery Equipment account.

Sale of a Fixed Asset. When a fixed asset is sold, the book value is removed from the ledger through a general journal entry in the same manner as when it is exchanged. The amount received from the fixed asset when sold is usually less than its book value, hence the sale of a fixed asset results in a decrease in proprietorship; this decrease is usually recorded in the same account as a decrease in proprietorship because of an exchange at less than book value.

June 1. Walker & Mills receive a check for \$75.00 for the sale of a safe, cost value \$200.00, book value \$100.00.

The general journal entry at the left and the cash book entry below record

June 1, 19						the change in assets and the decrease in proprietorship resulting from the sale of a fixed asset for less than its book value. The decrease in proprietor-	
v	Cash.....	75—		200—			
	Dep. Res. for O. E.....	100—					
	Loss on Exch. of F. A.....	25—					
	Office Equipment.....						

ship is recorded as a debit to the Loss on Exchange of Fixed Assets account.

CASH				Receipts	
19 June	1	√	Office Equipment	Sale of safe	75—

When a fixed asset is exchanged or sold at a time other than the beginning of a fiscal period, it is necessary to record as an expense the depreciation applicable to the asset for the fiscal period. Thus, if the transaction illustrated above occurred June 15, and the company operated on a monthly fiscal period, it would be necessary to record the depreciation for the fifteen days.

Discarded Fixed Assets. When a fixed asset is discarded because it is of no further use in the business and has no sale value, its book value is removed from the ledger through an entry in the general journal. The appropriate depreciation reserve account is debited for the recorded depreciation as shown by the fixed asset register and the fixed asset account credited for the cost value. If the fixed asset is not fully depreciated, the book value is debited to the Loss on Exchange of Fixed Assets account.

The entry in the illustration at the left records the decrease in proprietorship resulting from discarding a fixed asset which cost \$80.00 and has been

June 1, 19			
Dep. Res. on O. E.	60	—	
Loss on Exch. of F. A.	20	—	
Office Equipment.			80

depreciated \$60.00. The debit to the reserve account removes the recorded depreciation from the reserve account, the

debit to the Loss on Exchange of Fixed Assets account records the decrease in proprietorship because the fixed asset is discarded before it has been fully depreciated and the credit to the fixed asset account records the decrease in value of the fixed asset.

Fully Depreciated Fixed Assets. When the amount of the depreciation recorded on the line with a fixed asset in the fixed asset register equals the cost of the fixed asset, it has been fully depreciated. Thereafter no depreciation applicable to this asset will be recorded. The cost value of the fixed asset and the recorded depreciation applicable to it may be allowed to remain in the fixed asset and depreciation reserve accounts since the deduction of the depreciation from the fixed asset will permit the Balance Sheet to show the book value of fixed assets which have not been fully depreciated. When a fixed asset is fully depreciated, no entry is required in the general journal but a line should be drawn through the unused amount columns on the line with the fixed asset in the register to avoid the possibility of recording further depreciation.

REPORTS

Complete Reports Nos. 49 and 50 in the work book and submit it to the instructor for approval. Continue with the text discussion until Report No. 51 is required on page 216.

Bad Debts. No matter how careful a firm may be in extending credit, it is usually not possible to collect from all charge customers. Failure to collect from a charge customer results in a *bad debt*. A bad debt when recorded as such results in a decrease in the asset accounts receivable and a corresponding decrease in proprietorship; this decrease in proprietorship is referred to as *loss on bad debts*. While the failure to collect from the charge customer is a loss, yet it is usually regarded as one of the operating expenses. When a loss on bad debts is recorded, the account with the customer is said to be *charged off*.

Reserve for Bad Debts. It is usually not possible to determine that an account with a charge customer is worthless until several months and sometimes several years have elapsed. In view of this fact, it is customary to estimate at the close of each fiscal period the approximate loss because of bad debt resulting from charge sales during the period and to record this as an expense of the period. The estimate is usually based on a rate per cent of the total sales or of the charge sales for the period. The rate will be determined by comparing the loss on bad debts in various fiscal periods with the sales during these periods.

At the close of the fiscal period, June 30, the accountant for Walker & Mills was instructed to set up a reserve of one-eighth of 1% of the total sales, \$55,425.51, to provide for possible loss because of bad debts.

The illustration at the right shows the general journal entry required to record this reserve. An account with the title Loss on Bad Debts is debited to record the decrease in

proprietorship because of the anticipated failure to collect this amount from charge customers. An account with the title Reserve for Bad Debts is credited because it is not known which charge customers will fail to pay, hence their accounts can not be credited.

The illustration at the right shows the usual method of reporting accounts receivable and reserve for bad debts on the Balance Sheet. The amount of the estimated reserve is deducted from the total accounts receivable in the same manner as

Depreciation is deducted from the balance of the fixed asset account to which it applies. The amount that it is estimated will be collected from charge customers is the difference between the total accounts receivable and the Reserve for Bad Debts account.

Recording a Bad Debt. When it is decided that the account with a charge customer can not be collected, the account is removed from the ledger through an entry in the general journal. The Reserve for Bad Debts account is debited and the account with the charge customer credited for the amount of his indebtedness. When this entry is posted, the account with the charge customer (if a loose-leaf ledger is used) is removed from the ledger and placed in a special binder containing other uncollectible accounts.

May 15. The accountant for Walker & Mills was instructed to charge off the account with D. L. Monday, balance \$25.15.

The general journal entry at the top of page 215 records the decrease in assets and proprietorship resulting from the failure to collect from a charge

June 30, 19

Loss on Bad Debts.....	69 28	
Reserve for Bad Debts..		69 28
To record the esti-		
mated loss on bad debts.		

Accounts Receivable.....	6031 54	
Less Res. for Bad Debts	69 28	5962 26

customer. The debit to the Reserve for Bad Debts account reduces the amount of the reserve and the credit to the account with D. L. Monday closes his account. When

May 15, 19

this entry is posted, the sheet containing the account with D. L. Monday is removed from the ledger

	Reserve for Bad Debts	25 15	
	D. L. Monday		25 15
	Account uncollectible.		

and placed in a special binder but his account is not ruled. It is known that all accounts in the special binder are charged off but the account is left open so that if the account is paid at some time in the future the amount can be ascertained from the open account in the bad debts binder.

When a reserve for bad debts is not maintained, the expense, because of accounts receivable "charged off", is recorded as a debit to the Loss on Bad Debts account.

Collection of a Bad Debt. When cash is received from a charge customer whose account has been declared worthless and recorded as a bad debt, the transaction results in an increase in assets (usually cash) and a corresponding increase in proprietorship usually referred to as *bad debts collected*. This increase in proprietorship is an income and should not be recorded as a credit to the Reserve for Bad Debts account because the purpose of this account is to provide a reserve and not to contain a record of income.

Fixed Asset Accounts. The purpose of each fixed asset account is to contain a record of the increases in the fixed asset recorded in the account; the title of each account is descriptive of the fixed assets recorded in it. Each fixed asset account is *debited* for the cost of fixed assets purchased and *credited* for the cost of fixed assets sold, exchanged or discarded. The *debit* balance of each fixed asset account shows the total value of fixed assets recorded in it; this debit balance should agree with the cost value of fixed assets recorded in the fixed asset register and the inventory of the fixed assets on hand at the close of the fiscal period. The *debit balance* of each fixed asset account, the *depreciation reserve* applicable to each account, and the *book value* of each class of fixed assets are shown on the Balance Sheet.

Depreciation Reserve Accounts. The purpose of each depreciation reserve account is to record the decrease in the value of fixed assets because of depreciation; the title of each account should correspond with the title of the fixed asset account to which it relates. Each reserve account is *credited* at the close of the fiscal period with the estimated amount of depreciation applicable to the fiscal period and *debited* for the depreciation applicable to each fixed asset sold, exchanged or discarded. The *credit* balance of each reserve account is a deduction from the cost value of the fixed assets to which the reserve is applicable. It is shown on the Balance Sheet as a deduction from the debit balance of the appropriate fixed asset account. There should be on the ledger as many depreciation reserve accounts as there are fixed asset accounts.

Depreciation Expense Accounts. The purpose of each depreciation expense account is to contain a record of the expense resulting from the depreciation of fixed assets; the title of each depreciation expense account should include the title of the fixed asset account to which it is applicable. Each depreciation expense account is *debited* at the close of the fiscal period for the same amount as is recorded as a credit to a depreciation reserve account. The *debit* balance of each account is the depreciation expense applicable to the fixed asset indicated in the title of the account and is closed into the Profit and Loss Summary account.

If desired, depreciation expense may be recorded in the Profit and Loss Summary account instead of in separate expense accounts. The usual plan, however, is to open the expense accounts and transfer the balances to the Profit and Loss Summary account through the closing entries.

Reserve for Bad Debts Account. The purpose of this account is to show the amount of the estimated reserve set up to provide for loss on doubtful accounts that may occur in future fiscal periods. This account is *credited* at the close of each fiscal period for the estimated amount of loss on account of uncollectible accounts and *debited* for each loss resulting from failure to collect from a charge customer; the debit is recorded at the time the account is determined to be uncollectible. The *credit* balance is the reserve for bad debts and is shown on the Balance Sheet as a deduction from the total of the accounts receivable.

Loss on Bad Debts Account. The purpose of this account is to record the loss resulting from the failure to collect from charge customers. This account is *debited* for the estimated loss determined at the close of each fiscal period. The *debit* balance is the total expense because of loss on bad debts and is closed into the Profit and Loss Summary account.

When a reserve for bad debts is not set up at the close of each fiscal period, the amount of each loss is debited to the Loss on Bad Debts account at the time it is determined that the account with the charge customer was uncollectible.

Bad Debts Collected Account. The purpose of this account is to record the increase in income (increase in proprietorship) because of bad debts charged off and later collected. This account is *credited* for the amount of each collection from a charge customer whose account has been charged off. The credit balance is an income and closed into the Trading, Profit and Loss Summary account.

REPORTS

Complete Reports Nos. 51 and 52 in the work book and submit to the instructor for approval. Continue with the text discussion until Report No. 53 is required on page 220.

CHAPTER XVIII

ACCRUALS

A transaction is a change in assets, liabilities, assets and liabilities or assets and proprietorship. Transactions are usually recorded at the time the changes occur. The exceptions are the changes in the asset merchandise because of sales, the changes in deferred assets because of the use of supplies, and the changes in fixed assets because of depreciation; changes of this character are usually recorded at the close of the fiscal period as explained in previous chapters. The discussion in this chapter relates to another type of changes in assets, liabilities and proprietorship which are usually recorded at the close of the fiscal period.

Accrued Income. An increase in one asset without a corresponding decrease in another asset always results in an increase in proprietorship which is referred to in accounting as income. Accrued income is income which is the result of an increase in assets because of a contract or agreement. The accrued interest on an interest-bearing note receivable is an example of accrued income. The face of the note is recorded as an asset in the Notes Receivable account at the time the note is received. The value of this asset will, however, increase day by day because of the agreement by the maker of the note to pay interest at the maturity of the note.

A 30-day 6% interest-bearing note, face \$6,000.00, dated December 16, in favor of Hupp Bros., is an asset of \$6,000.00 at the close of business December 16, an asset of \$6,001.00 at the close of business December 17, \$6,002.00 at the close of business December 18, \$6,003.00 at the close of business December 19, and \$6,004.00 at the close of business December 20. This asset will increase \$1.00 each day until the maturity of the note January 15 at which time its value will be \$6,030.00. The daily increase in the value of the asset notes receivable because of the accrued interest is referred to as an *accrued asset* and the income resulting from this accrued asset, as *accrued income*.

Recording Accrued Income when Collected. When an interest-bearing note is collected at maturity, the amount of cash received is greater than the face of the note because of the interest which has been accruing day by day. Applying this statement to the \$6,000.00 6% interest-bearing note discussed in the preceding paragraph, the entry in the cash book of Hupp Bros. to record the \$6,030.00 cash received at the maturity of the note January 15 is:

CASH				Receipts			
19							
Jan.	15	Notes Receivable	Note dated Dec. 16	6000	—		
	15	Interest Income	On above note	30	—		

Recording Accrued Income at the Close of a Fiscal Period. The plan of recording the asset accrued interest on notes receivable as a debit to the Cash account and a credit to the Interest Income account at the time the note is collected is satisfactory when the date and maturity of the note both occur in the same fiscal period and the note is collected at maturity. When an interest-bearing note is dated in one fiscal period but does not mature until a subsequent fiscal period, it will be necessary to record the accrued interest and resulting accrued income at the close of the fiscal period. This is necessary that the Balance Sheet may show all the assets and the Profit and Loss Statement all the income earned during the period.

Accrued assets and the resulting accrued income are usually not recorded as such except at the close of the fiscal period when the contract does not mature until a succeeding fiscal period. The method of recording accrued assets and accrued income at the time the contract is completed and at the close of the fiscal period is explained in the paragraphs which follow.

The asset value of an interest-bearing note at the close of the fiscal period is the face of the note plus interest from date of the note up to and including the last day of the fiscal period. The face of the note is shown recorded as an asset in the Notes Receivable account but the record does not show the increased value because of accrued interest. The entry in the general journal to record the accrued interest requires a debit to an account with the title Accrued Interest on Notes Receivable or Accrued Interest and a credit to the Interest Income account. In other words, the increase in assets is recorded in an account which indicates by its title that it is an accrued asset but the accrued income is recorded in the same income account as income collected.

The 30-day 6% interest-bearing note for \$6,000.00 referred to in the third paragraph on page 217 is dated December 16, hence does not mature until January 15. If the fiscal year or monthly fiscal period of Hupp Bros. ends December 31, the value of the note is \$6,015.00 because of the accrued interest for 15 days, \$15.00.

The entry in the illustration at the left shows the method of recording the

December 31, 19	
Accrued Int. on Notes Rec.	15
Interest Income.....	15
To record the accrued interest on notes receivable.	

accrued asset and accrued income December 31 in the general journal of Hupp Bros. The Accrued Interest on Notes Receivable account is debited to record the increase in assets and the Interest Income account is credited to record the accrued income which is interest earned but not yet collected.

The title of an account in which the value of an accrued asset is recorded should be descriptive of the nature of the asset. The title Accrued Interest on Notes Receivable is consistent as it relates to the accrual recorded in the account. If the account includes the accrued interest on other types of contracts, as certificates of deposits, monthly bank balance and bonds, the title of the account may be Accrued Interest.

Collecting Recorded Accrued Interest. When accrued interest is recorded at the close of a fiscal period, it is necessary to give this fact consideration when the note and interest are collected in a subsequent fiscal period. Thus, when the \$6,000.00 note referred to is collected January 15, the amount of cash received is \$6,030.00, \$6,000.00 face of the note and \$30.00 interest. This \$30.00 is not all income, however, because part of it was recorded as interest income, December 31. That part recorded as interest income, December 31, is also recorded as an asset of \$15.00 in the Accrued Interest on Notes Receivable account; consequently, when the \$6,030.00 cash is collected, the asset cash increases the amount of cash received, the asset accrued interest on notes receivable decreases \$15.00, the asset notes receivable decreases \$6,000.00, and the interest income increases \$15.00. The entry in the illustration below shows the method of recording the collection of the \$6,000.00 note, January 15.

CASH				Receipts			
19							
Jan.	15	Notes Receivable	Note dated Dec. 15	6000	—		
	15	Accrued Interest on Notes Rec.	On above note	15	—		
	15	Interest Income	On above note	15	—		

The Notes Receivable account is credited for the face of the note to record the decrease in the asset notes receivable, the Accrued Interest on Notes Receivable is credited to record the decrease in the asset accrued interest on notes receivable and the Interest Income account is credited to record the increase in proprietorship because of interest earned in the current fiscal period. When these entries are posted, the Accrued Interest on Notes Receivable account will be in balance and the \$15.00 income earned because of the use of \$6,000.00 for 15 days during the current fiscal period will be recorded as a credit to the Interest Income account.

Accrued Income at the Close of a Fiscal Period. The usual accrued income to be recorded at the close of the fiscal period is accrued interest on notes receivable. The debit balance of the Notes Receivable account at the close of the fiscal period always indicates that there may be accrued interest to record because of interest-bearing notes. The amount of the interest to be recorded at that time is the accrued interest on all interest-bearing notes from the date of each note up to and including the last day of the fiscal period. The entry in the general journal to record all the interest requires a debit to the Accrued Interest on Notes Receivable account (or any other descriptive title) and a credit to the Interest Income account. In other words, the entry to record the accrued interest on any number of notes would be the same form as the entry on page 218 but the amount would be all the accrued interest.

You must keep in mind the fact that the accrued income recorded at the close of the fiscal period can be only that which is the result of a specific agreement. Accrued income does not include the increase in value of property, such as merchandise, because the price has increased or real estate because it may be sold for more than the cost.

Accrued Interest on Notes Receivable Account. The purpose of this account is to record the increase and decrease in the asset accrued interest on notes receivable. This account is *debited* at the close of the fiscal period with the accrued interest on interest-bearing notes and *credited* in a subsequent fiscal period when the interest is collected or when the reverse entry is made on the first day of the next fiscal period as explained on page 226.

The *debit* balance of the Accrued Interest on Notes Receivable account is an asset at the close of the fiscal period and is shown on the Balance Sheet as an asset. If the reverse entry is made on the first day of the fiscal period, this account will be in balance during the fiscal period.

Unless the amounts are large, all accrued interest at the close of each fiscal period is recorded as a debit to this account.

REPORTS

Complete Report No. 53 in the work book and present it for approval. Continue with the text discussion until Report No. 54 is required on page 227.

Accrued Expenses. An increase in a liability without a corresponding increase in an asset or decrease in a liability results in a decrease in proprietorship referred to in accounting as an expense. Accrued expense is expense which is the result of an increase in liabilities because of a contract or agreement. Accrued interest on an interest-bearing note payable, unpaid wages due employees, unpaid expense bills, and unpaid property taxes are examples of accrued expenses.

Accrued Interest on Notes Payable. The liability because of an interest-bearing note payable increases day by day until the note is paid. Thus, a 30-day 6% interest-bearing note payable for \$7,500.00, dated December 16, signed by Hupp Bros., will be a liability of \$7,501.25 December 17, \$7,502.50 December 18, and \$7,503.75 December 19. In the same manner it will continue to increase \$1.25 each day until maturity, January 15, at which time the amount of the liability is \$7,537.50. The daily increase in the amount of this liability because of the accrued interest is referred to as an *accrued liability* and the expense resulting from this accrued liability, as *accrued expense*.

The accrued liability and resulting increase in interest expense because of accrued interest on notes payable is usually not given consideration except at the close of the fiscal period.

Recording Accrued Interest Expense. The accrued interest resulting from accrued liabilities is usually not recorded until the contract is completed. Applying this to the \$7,500.00 interest-bearing note discussed in the preceding paragraph, the entry January 15 to record the cash paid at the maturity of the note is shown at the top of page 221.

CASH				Payments	
19					
Jan.	15	Notes Payable	Note dated December 16	7500	—
	15	Interest Expense	On above note	37	50

The plan illustrated is satisfactory when the date and maturity of the note both occur in the same fiscal period. When the interest-bearing note, however, is dated in one fiscal period but does not mature until a subsequent fiscal period, it will be necessary to record the accrued liability and resulting accrued expense at the close of the fiscal period. This is necessary that the Balance Sheet may show all the liabilities correctly and the Profit and Loss Statement the net profit for the fiscal period.

The 30-day 6% interest-bearing note for \$7,500.00 referred to on page 220 is dated December 16, hence does not mature until January 15. If the fiscal year or monthly fiscal period ends December 31, the accrued liability and the accrued interest at that time is \$18.75.

The entry in the illustration at the right shows the method of recording the accrued liability and the accrued expense December 31, in the general journal of Hupp Bros. The Interest Expense account is debited to record the increase in expense resulting from the use by the business of money belonging to others. The increase in

December 31, 19			
	Interest Expense.....	18	75
	Accd. Int. on Notes Pay.		18 75
	To record the accrued interest on notes payable.		

the liability is recorded as a credit to an account with the title Accrued Interest on Notes Payable. If desired, the title of this account may be Accrued Interest or any other title which is descriptive of the purpose of the account.

Payment of Accrued Interest. Recording the accrued expense at the close of a fiscal period because of accrued liabilities makes it necessary to give consideration to this record at the maturity of the contract in a subsequent fiscal period. Thus, when the \$7,500.00 note referred to is paid January 15, the amount of cash required to pay it is \$7,537.50, \$7,500.00 face of the note and \$37.50 interest. The interest for the first fifteen days, however, has already been recorded as expense, hence only the interest for the remaining fifteen days is expense for the fiscal period beginning January 2.

This transaction results in a decrease in the asset cash \$7,537.50, a decrease in the liability notes payable \$7,500.00, a decrease in the liability accrued interest on notes payable \$18.75, and a decrease in the proprietorship (interest expense) for \$18.75. The entry on the payments side of the cash book to record the transaction is shown at the top of page 222.

CASH				Payments			
19							
Jan.	15	Notes Payable	Note dated Dec. 16	7500	—		
	15	Accrued Interest on Notes Pay.	On above note	18	75		
	15	Interest Expense	On above note	18	75		

When this entry is posted, the Accrued Interest on Notes Payable account will be in balance and the interest expense for January will be recorded as a debit to the Interest Expense account.

Accrued Salaries or Wages. When an employee receives his compensation weekly or monthly, the amount due him at the end of each business day from the beginning of the contract is an accrued liability. Thus, if Hupp Bros. employ you as assistant accountant at a salary of \$24.00 per week and you begin work Monday morning, December 29, you will receive \$24.00 Saturday night. At the close of business Monday, December 29, they owe you \$4.00, Tuesday \$8.00, Wednesday \$12.00, Thursday \$16.00, Friday \$20.00, and Saturday \$24.00. In other words, their liabilities increase \$4.00 each day because of the agreement to pay you \$24.00 a week for your services. Accrued wages and the resulting accrued liability and expense are usually not given consideration except at the close of the fiscal period and then only when the pay day and the close of the fiscal period occur on different dates.

The accrued expense resulting from accrued wages is usually not recorded until the contract is completed. Applying this to your salary as accountant discussed in the preceding paragraph, you would receive \$24.00 Saturday night and record it on the payments side of the cash book as follows:

CASH				Payments			
19							
Jan.	3	Office Salaries	Salary of accountant for 1 week	24	—		

The plan illustrated is satisfactory throughout the fiscal period and at the close of the fiscal period when pay day and the close of the fiscal period occur on the same date; when on different dates, it is necessary to record the liability because of accrued wages. Unless the expense resulting from the accrued liability is recorded at the close of the fiscal period, the Balance Sheet will not show the liabilities correctly and the Profit and Loss Statement will not show the correct net profit.

The entry in the illustration at the right shows the method of recording the accrued liability and accrued expense because of the salary due you December 31, the close of the business year. You began work Monday morning December 29, hence have worked 3 days or one-half of the week, hence the

December 31, 19			
Office Salaries	12	—	
Accrued Salaries			12
To record the accrued wages due accountant.			

amount of the liability is \$12.00. The Office Salaries account is debited to record the increase in the expense because of office salaries and an account with the title Accrued Salaries is credited to record the accrued liability.

Payment of Accrued Salaries. Recording the office salaries at the close of the fiscal period because of the accrued liability makes it necessary to give consideration to this record when the salaries are paid on pay day. Thus, when you receive your weekly salary of \$24.00 Saturday, January 3, the transaction results in a decrease in the asset cash \$24.00, a decrease in the liability accrued salaries \$12.00, and an increase in the expense office salaries \$12.00. The entry to record this transaction on the payments side of the cash book is:

CASH				Payments			
19							
Jan.	3	Accrued Salaries	Accountant's Salary	12	—		
	3	Office Salaries	Accountant's Salary	12	—		

Accrued Expenses. Metered services such as electricity, gas, and water will accrue day by day because of daily service rendered. The usual plan is for the company rendering the service to read the meter monthly, render a bill for the value of the service, and collect for it at that time. When the bill for this service is paid, the accrued liability resulting from the daily increase in the cost of the service is canceled through payment of the bill.

The accrued liability and resulting accrued expense because of metered services are usually not given consideration except at the close of the fiscal period

Recording Accrued Expenses. When a bill is received for metered service, the bill is paid, hence the liability is not recorded. The entry in the illustration below is to record the payment of the November electric bill received and paid by Hupp Bros. December 8.

CASH				Payments			
19							
Dec.	8	General Expense	November electric bill	14	50		

This plan is satisfactory when the bill is paid in the same fiscal period in which the service is rendered. When the service is rendered in one fiscal period and the bill not received until a subsequent fiscal period, it will be necessary to record at the close of the fiscal period the increase in the liability and expense because of the service. This is necessary that the Balance Sheet may show the liabilities correctly and the Profit and Loss Statement the correct net profit for the period.

The liability at the close of a fiscal period because of metered service rendered is determined by reading the meter and ascertaining the value of the service at the unit price for the number of units used. The value of this service

which has been consumed but not paid for is recorded as a debit to an expense account and the amount of the liability as a credit to an account with the title **Accrued Expense**.

The entry in the illustration at the right is to record at the close of the December 31 fiscal period the accrued liability because of electricity consumed during December. It may

be assumed that the amount is obtained in the manner described in the preceding paragraph. The General Expense account is debited because this account is debited when electric bills are paid; the Accrued Expense account is credited to record the accrued liability because this electric bill has not yet been paid.

December 31, 19			
	General Expense.....	11 87	
	Accrued Expense.....		11 87
	To record the accrued electric light expense.		

Payment of Accrued Expenses. The entry in the illustration below records the payment of the electric bill, January 8, following the close of the fiscal period, December 31. The increased amount paid is because of the electricity consumed the first week in January. This transaction results in a decrease in the asset cash for the amount paid, a decrease in the liability accrued expense for the amount recorded, December 31, and an increase in the general expense for the electricity consumed in January. The entry to record the transaction on the payments side of the cash book is:

CASH				Payments	
19					
Jan.	8	Accrued Expense	December electric light bill	11 87	
	8	General Expense	December electric light bill	2 35	

Accrued Property Tax. Property taxes are usually assessed annually and payable at a definite time during the year. When the taxes assessed have not been paid at the close of the fiscal period because the date of payment as fixed by the tax commission occurs in a subsequent fiscal period, it is necessary to record at the close of the fiscal period the liability because of unpaid taxes or as referred to in accounting, accrued taxes. The amount of the accrued taxes which may be either known or estimated is referred to as the liability *accrued property taxes*. Recording the liability accrued taxes results in an increase in the liability *accrued property taxes* and an increase in the expense *property taxes*.

The entry in the illustration at the left records the accrued taxes of

December 31, 19			
	Property Taxes.....	198 42	
	Accrued Property Taxes		198 42
	Accrued taxes on property at close of fiscal period.		

\$198.42 owed by Hupp Bros. at the close of the fiscal period, December 31. The debit to the Property Taxes account records the increase in expense be-

cause of property taxes and the credit to the Accrued Property Taxes account records the liability because the taxes are not yet paid.

Payment of Accrued Property Taxes. Recording the accrued expense because of unpaid property tax at the close of the fiscal period makes it necessary to give consideration to this record when the tax bill is paid in a subsequent fiscal period. Payment of the tax bill results in a decrease in the asset cash for the amount paid, a decrease in the liability accrued property taxes for the amount of the recorded liability, and an increase in the property taxes if the amount of the bill is more than the recorded liability.

The entry in the illustration below is to record the payment of the tax bill for \$206.17 rendered to Hupp Bros., January 5. The Cash account is credited to record the decrease in the asset cash, the Accrued Property Tax account is debited to record the decrease in the liability accrued property taxes, and the Property Taxes account is debited to record the expense which is the excess of the tax bill over the accrued taxes recorded June 30.

		CASH		Payments	
19					
Jan.	5	Accrued Property Taxes	Taxes on property	198	42
	5	Property Taxes	Taxes on property	7	75

When this entry is posted, the Accrued Property Taxes account will be in balance and the debit balance of the Property Taxes account will show the expense because of taxes paid in excess of the estimate.

When the recorded liability because of unpaid taxes is based on estimate and the amount of the tax paid is less than the estimate, the balance of the Accrued Property Taxes account may be transferred to the credit of the Property Taxes account. When the business is operated on a monthly fiscal period basis and the property tax is paid at a time when less than eleven months accrued taxes are recorded, it will be necessary to record as an asset the taxes paid in advance applicable to future fiscal periods; the title of the account may be Prepaid Property Taxes. At the close of subsequent fiscal periods the amount of this asset will be reduced by being transferred to the Property Taxes account in the same manner as prepaid insurance is transferred to the Expired Insurance account.

Accrued Expenses. At the close of the fiscal period the following accrued expenses may require consideration:

- (1) Accrued interest on interest-bearing notes payable.
- (2) Accrued salaries or wages because pay day is not the same date as the close of the fiscal period.
- (3) Accrued expenses because of metered services or other unpaid expenses.
- (4) Accrued property taxes because of unpaid taxes which have not been recorded as an accrued liability.

The Notes Payable and Salaries accounts on the Trial Balance indicate that there may be accrued expenses to record. There may be no accounts on

the Trial Balance which indicate metered services or property taxes but these accrued expenses are always expected, hence the accountant must investigate them at the close of each fiscal period.

Adjustments for Accrued Income and Expense. It is customary at the beginning of each fiscal period to make *reverse* entries for the accruals recorded at the close of the preceding fiscal period which will mature during the current fiscal period. Unless these reverse entries are made, it will be necessary to analyze each collection of interest and each payment of interest, salaries, metered expenses, etc., during the fiscal period. As illustrated in connection with the discussion of each class of accrued expense, this analysis is necessary in order that the proper record may be made to remove the accruals from the records. Since these reverse entries are usually made after the ledger is closed at the end of the fiscal period, they are sometimes termed *post-closing entries*.

The entries required January 2 to reverse the entries for the accruals recorded at the close of the preceding fiscal period, December 31, are illustrated below. The first entry is to reverse the entry to record the accrued interest on notes receivable as illustrated on page 218 and the second entry, the ac-

crued expenses as illustrated on pages 221, 222, and 224.

January 2, 19			
Interest Income.....	15—		
Acc. Int. on Notes Rec.		15—	
To adjust the Accrued			
Interest on Notes Re-			
ceivable account.			
2			
Accd. Int. on Notes Pay...	18 75		
Accrued Salaries.....	12 —		
Accrued Expense.....	11 87		
Interest Expense.....		18 75	
Office Salaries.....		12 —	
General Expense.....		11 87	
To adjust the accrued			
liability accounts.			

When these entries are posted the accrued asset and accrued liability accounts will be in balance and the income and expense accounts affected debited or credited. When an income which was accrued at the close of the preceding fiscal period is

collected, it is recorded in the same manner as if the accrual had not been recorded.

When an expense which was accrued at the close of the preceding fiscal period is paid, it is recorded in the same manner as if the expense had not been recorded. In other words, the reverse entries make it unnecessary to analyze each collection of income and payment of an expense in order to record the transaction so as to remove a recorded accrual from the ledger.

The accrued property tax recorded in the entry at the bottom of page 224 is not reversed because the bill for property tax is usually rendered only once each year. Consequently, the current transactions in each fiscal period, except the one in which the tax bill is received, do not affect the accrued liabilities recorded.

Accrued Interest on Notes Payable Account. The purpose of this account is to contain a record of the liability accrued interest on notes payable.

It is *credited* at the close of each fiscal period for the accrued interest on interest-bearing notes payable and *debited* in a subsequent fiscal period for the same amount as the credit. Usually the debit entry is made on the first day of the following fiscal period.

The *credit* balance of the Accrued Interest on Notes Payable account is a liability and shown as such on the Balance Sheet. Since the account is usually debited at the beginning of the next fiscal period for its credit balance, it is in balance throughout the fiscal period.

Accrued Wages Account. The purpose of this account is to contain a record of the liability accrued wages. It is *credited* at the close of the fiscal period for the wages due employees and *debited* in a subsequent fiscal period for the same amount; the debit is usually on the first day of the next fiscal period.

The *credit* balance of this account is a liability and shown as such on the Balance Sheet. Since it is usually debited with the credit balance at the beginning of the fiscal period, it is in balance throughout the period.

Accrued Expense Account. The purpose of this account is to contain a record of the liability accrued expense. It is *credited* at the close of the fiscal period for the accrued expenses and *debited* in a subsequent fiscal period for the same amount; the debit is usually on the first day of the next fiscal period.

The *credit* balance of this account is a liability and shown as such on the Balance Sheet. Since it is usually debited with the credit balance at the beginning of the fiscal period, it is in balance throughout the period.

Accrued Property Tax Account. The purpose of this account is to contain a record of the accrued property taxes. It is *credited* at the close of each fiscal period for the unpaid taxes applicable to the fiscal period and *debited* at the time this liability is canceled through payment of the taxes.

The *credit* balance shows the amount of accrued property taxes unpaid. This account usually remains open until the property tax is paid, hence is not included in the reverse entries at the beginning of the fiscal period illustrated on page 226.

REPORTS

Complete Reports Nos. 54 and 55 in the work book and present for approval. Continue with the text discussion until Report No. 56 is required on page 231.

CHAPTER XIX

CONTROLLING ACCOUNTS

The discussion in Chapter XII relates to efficient methods of applying accounting procedure through the use of columnar journals. The discussion in this chapter relates to efficient methods through the use of controlling accounts in the general ledger. In other words, you have learned in Chapter XII how to record transactions efficiently in the journals and in this chapter you will learn how to record them more efficiently in the ledger.

Accounts Receivable Control. When merchandise is sold on credit, an account is required with each charge customer. When all the accounts including those with charge customers are kept in one ledger, it is necessary to use each account balance when preparing the Trial Balance. Much time and effort may be saved in the preparation of the Trial Balance when one account contains a record in summary form of all the accounts with charge customers. This saving of time may be secured through an Accounts Receivable control.

The accounts receivable control not only provides a more efficient means of preparing the Trial Balance but also provides for the services of one or more assistants in connection with recording the transactions. Thus, with an accounts receivable control one or more assistants may be assigned to record the transactions with charge customers with the assurance that the chief accountant will know that the work of each assistant is correct. In other words, the accounts receivable control provides the chief accountant with a check on the work of one or more assistants.

To maintain an accounts receivable control, an account is kept with each charge customer usually in a separate ledger known as the *accounts receivable ledger* and referred to as a *subsidiary ledger*. The ledger which contains all the accounts except those with charge customers and contains a summary of the customers accounts in one account is referred to as the *general ledger*. The title of each account in the accounts receivable ledger is the name and address of the charge customer. The title of the summary or control account in the general ledger is *Accounts Receivable*.

Journals for Accounts Receivable Control. In a mercantile business the usual journals required either with or without accounts receivable control are the sales journal, cash receipts journal (cash receipts side of the cash book) and the general journal. In other words, maintaining an accounts receivable control does not require the use of special journals but it does require the use of special columns in some of the journals.

Sales Journal for Accounts Receivable Control. The sales on credit are recorded in a sales journal in the same manner whether or not an accounts receivable control is maintained. The ruling of the sales journal as in the sketch below is similar to that shown in previous illustrations.

Date	L. F.	Account Debited	Address	Terms	Sale No.	Amount

Each amount in the Amount column is posted to the debit of the account with the charge customer in the accounts receivable ledger written on the same line with it; this posting is usually daily. At the end of the month the total of the sales journal is posted to the credit of the Sales account and to the debit of the Accounts Receivable account. In other words, the sum of the various debits recorded in the accounts receivable ledger is recorded in one amount in the Accounts Receivable account in the general ledger.

Cash Book for Accounts Receivable Control. When the accounts receivable control is maintained and sales discount is involved, it is necessary to provide at least four columns on the receipts side of the cash book as shown in the sketch below.

Date	L. F.	Account Credited	Explanation	General Ledger Cr.	Accounts Receivable Cr.	Sales Discount Dr.	Net Cash Dr.

This illustration is the same as the cash book on page 150 except the one column which contains amounts to be posted daily is divided into two columns because there are two ledgers. Amounts to be posted to the general ledger are entered in the General Ledger column and amounts to be posted to the accounts receivable ledger, in the Accounts Receivable Ledger column.

Each amount in the Accounts Receivable, Cr. column is posted to the credit of the account in the accounts receivable ledger written on the line with it; this posting is usually daily. At the end of the month the total of the amounts posted to the credit of the accounts in the accounts receivable ledger is posted to the credit of the Accounts Receivable account in the general ledger.

General Journal for Accounts Receivable Control. Two additional columns are required in the general journal when an accounts receivable control is maintained as shown in the sketch below.

Date	L. F.	Name of Account and Explanation	General Ledger Dr.	General Ledger Cr.	Accounts Receivable Dr.	Accounts Receivable Cr.

Four columns are provided for amounts to be posted to (a) the debit side of accounts in the general ledger, (b) the credit side of accounts in the general ledger, (c) the debit side of accounts in the accounts receivable ledger and (d) the credit side of accounts in the accounts receivable ledger.

Each amount entered in the Accounts Receivable Ledger, Dr. column is posted to the debit of the account in the accounts receivable ledger written on the same line with it and each amount entered in the Accounts Receivable, Cr. column is posted to the credit of the account in the accounts receivable ledger written on the same line with it; these postings are daily. At the end of the month the total of the Accounts Receivable, Dr. column is posted to the debit of the Accounts Receivable account in the general ledger and the total of the Accounts Receivable, Cr. column is posted to the credit of the Accounts Receivable account in the general ledger.

Trial Balance for Accounts Receivable Control. The Trial Balance is prepared from the general ledger without reference to the accounts in the accounts receivable ledger. The correctness of the record in the accounts receivable ledger whether maintained by the chief accountant or by an assistant is proved by the balance of the Accounts Receivable account in the general ledger. The sum of the debit balances of the accounts in the accounts receivable ledger should equal the balance of the Accounts Receivable account in the general ledger.* The method of proof for the accounts receivable ledger does not detect errors in posting to the wrong accounts; it only proves that the total debit balances are correct.

When the Trial Balance prepared from the general ledger does not balance, the error will be detected through checking the posting to the general ledger; the entries in the accounts receivable ledger do not affect the equality of the debits and credits in the general ledger. If the general ledger is in balance, and the sum of the balances of the accounts in the accounts receivable ledger does not equal the balance of the Accounts Receivable account in the general ledger, the error is detected through checking the posting to the accounts in the accounts receivable ledger.

A Trial Balance prepared from the general ledger is usually referred to as a *general ledger Trial Balance*. A list of the account titles and balances in the accounts receivable ledger is usually referred to as an *abstract of the accounts receivable ledger*.

Accounts Receivable Control Account. The purpose of this account is to provide in summary form a record of the changes in the asset accounts receivable. The control account is *debited* at the end of each month for the total of the sales journal and the total of the Accounts Receivable, Dr. column in the general journal; it is *credited* for the total of the Accounts Receivable

*The sum of the debit balances in the accounts receivable ledger should agree with the balance of the Accounts Receivable control account. Should one or more customers overpay their accounts, the amount of the overpayments (credit balances) is subtracted from the total of the debit balances to ascertain proof.

Ledger columns in the cash book and general journal. The *debit* balance is the amount of the asset accounts receivable and is shown on the Balance Sheet as one of the current assets.

REPORTS

Complete Report No. 56 in the work book and present it for approval. Continue with the text until Report No. 57 is required on page 233.

Accounts Payable Control. When merchandise is purchased on credit, an account is required with each creditor. When all the accounts including those with creditors are kept in one ledger, it is necessary to use each balance when preparing the Trial Balance. Much time and effort may be saved in the preparation of the Trial Balance when one account contains a record in summary form of all the accounts with creditors. This saving may be secured through an Accounts Payable control.

The accounts payable control not only provides a more efficient means for preparing the Trial Balance but also provides for the services of one or more assistants in recording transactions. With the accounts payable control the chief accountant has a check on the work of the assistants.

The plan for accounts payable control is the same as that for accounts receivable. An account is maintained with each creditor in the accounts payable ledger. The correctness of the record in the accounts payable ledger is proved through the balance of an account with Accounts Payable in the general ledger.

Journals for Accounts Payable Control. Maintaining an accounts payable control does not require the use of journals other than those required when the control is not maintained. In a mercantile business the usual journals required either with or without accounts payable control are the purchases journal, cash payments journal (payments side of the cash book) and the general journal.

Purchases Journal for Accounts Payable Control. The purchases on credit are recorded in a purchase journal in the same manner whether or not an accounts payable control is maintained. The ruling of the purchases journal in the sketch below is similar to that shown in previous illustrations.

Date	L. F.	Account Credited	Address	Terms	Inv. Date	Amount

Each amount in the Amount column is posted to the credit of the account with the creditor in the accounts payable ledger written on the same line with it; this posting is usually daily. At the end of the month, the total of the purchases journal is posted to the credit of the Accounts Payable account and to the debit of the Purchases account. In other words, the sum of the various credits recorded in the accounts payable ledger is recorded in one amount in the Accounts Payable account in the general ledger.

Cash Book for Accounts Payable Control. When the accounts payable control is maintained and purchases discount is involved, it is necessary to provide at least four columns on the payments side of the cash book as shown in the sketch below.

Date	L. F.	Account Debited	Explanation	General Ledger Dr.	Accounts Payable Dr.	Pur. Disct. Cr.	Net Cash Cr.

This illustration is the same as the cash book on page 151 except the one column which contains amounts to be posted daily is divided into two columns because there are two ledgers. Amounts to be posted to the general ledger are entered in the General Ledger column and amounts to be posted to the accounts payable ledger, in the Accounts Payable Ledger column.

Each amount in the Accounts Payable, Dr. column is posted to the debit of the account in the accounts payable ledger written on the line with it; this posting is usually daily. At the end of the month the total of the amounts posted to the debit of the accounts in the accounts payable ledger is posted to the debit of the Accounts Payable account in the general ledger.

General Journal for Accounts Payable Control. Two additional columns are required in the general journal when an accounts payable control is maintained as shown in the sketch below.

Date	L. F.	Name of Account and Explanation	General Ledger Dr.	General Ledger Cr.	Accounts Payable Dr.	Accounts Payable Cr.

Each amount entered in the Accounts Payable Ledger, Dr. column is posted to the debit of the account in the accounts payable ledger written on the same line with it and each amount entered in the Accounts Payable, Cr. column is posted to the credit of the account in the accounts payable ledger written on the same line with it; these postings are daily. At the end of the month the total of the Accounts Payable, Dr. column is posted to the debit of the Accounts Payable account in the general ledger and the total of the Accounts Payable, Cr. column is posted to the credit of the Accounts Payable account.

Trial Balance for Accounts Payable Control. The Trial Balance is prepared from the general ledger without reference to the accounts in the accounts payable ledger. Thus, the chief accountant prepares his Trial Balance from the general ledger without reference to the one or more accounts payable ledgers which contain the accounts with creditors. The correctness of the record in the accounts payable ledger whether maintained by the chief accountant or by an assistant is proved through the balance of the Accounts Payable account in the general ledger.

When the Trial Balance prepared from the general ledger does not balance, the error will be detected through checking the posting to the general ledger; the entries in the accounts payable ledger do not affect the equality of debits and credits in the general ledger. If the general ledger is in balance, and the sum of the balances of the accounts in the accounts payable ledger does not equal the balance of the Accounts Payable account in the general ledger, the error is detected through checking the posting to the accounts in the accounts payable ledger.

A Trial Balance prepared from the general ledger is usually referred to as a *general ledger Trial Balance*. A list of the account titles and balances in the accounts payable ledger is usually referred to as an *abstract of the accounts payable ledger*.

Accounts Payable Control Account. The purpose of this account is to provide in summary form a record of the change in the liability accounts payable. The control account is *credited* at the end of each month for the total of the purchases journal and the total of the Accounts Payable, Cr. column in the general journal; it is *debited* for the total of the Accounts Payable Ledger columns in the cash book and general journal. The *credit* balance is the amount of the liability accounts payable and is shown on the Balance Sheet as one of the current liabilities.

The sum of the credit balances in the accounts payable ledger should agree with the balance of the Accounts Payable control account. Should one or more accounts be overpaid, the amount of the overpayments (debit balances) is subtracted from the total of the credit balances to ascertain proof.

REPORTS

Complete Reports Nos. 57 and 58 in the work book and present for approval. Continue with the text discussion until Report No. 59 is required on page 246.

Illustrations. The method of recording transactions in the journals and ledgers for Accounts Receivable and Accounts Payable control accounts is further explained by illustrations. These illustrations include the journals either in whole or in part containing a record of the transactions completed by Wolfe & Marx, wholesale paper merchants, during the monthly fiscal period of March. The journals illustrated are (1) purchases journal, (2) sales journal, (3) cash receipts journal, (4) check register, (5) petty cash book, and (6) general journal.

The illustrations not only provide information regarding controlling accounts but also for recording transactions so as to ascertain gross profit on sales of merchandise by departments. The merchant is not only interested in knowing the profit made by selling merchandise but also the profit made through sales by departments.

Purchases Journal. The purchases journal illustrated on page 234 contains a record of the fourteen purchases made during March. Wolfe & Marx maintain two departments known as Departments A and B. Department A

includes writing, ledger, bond and other fine paper, and Department B, wrapping paper and twine.

Maintaining two departments makes necessary three money columns, (1) the amount of each purchase, (2) the amount of each purchase for Department A, and (3) the amount of each purchase for Department B. You will observe that when a purchase for the two departments is made from one firm that the amount entered in the Accounts Payable column equals the sum of the amounts in the other two columns.

PURCHASES JOURNAL									
March, 1930									
DATE	L F	ACCOUNT CREDITED	ADDRESS	TERMS	INVOICE DATE	AMOUNT	DEPT. A PURCHASES CR.	DEPT. B PURCHASES DR.	ACCOUNTS PAYABLE CR.
2	✓	Judson Twine Co.	Ruston	3/10-n/30	2/24	627.50	627.50		
2	✓	Case Mfg. Co.		Apr. 1, 3/10-n/30	2/27	948.75	632.50	316.25	
2	✓	Beck Paper Co.				522.25		522.25	
2	✓	Brown Paper Co.	Bedford			227.50	227.50		
3	✓	Nelson Roofing Co.	Buffalo	4/10-n/30	3/2	122.00			
3	✓	Jamaica Paper Co.	Jamaica			318.50		318.50	
6	✓	Reynolds Printing Co.	City			718.50	718.50		
9	✓	The Boomer Twine Co.	Brooklyn	1/10-n/30	3/5	375.00	375.00		
18	✓	James H. Nelson	Bedford			237.50		237.50	
22	✓	American Envelope Co.	Bedford			52.75	52.75		
25	✓	Dempsey Paper Co.	Irvington	3/10-n/30	3/23	5.25	5.25		
27	✓	James H. Nelson	Jamaica	1/10-n/30	3/25	621.65		621.65	
29	✓	Mead Paper Co.	City	3/10-n/30	3/27	855.40	641.55	213.85	
31	✓	Standard Paper Co.	City	Apr. 1, 1/10-n/30	3/27	275.90	275.90		
31	24	Accounts Payable, Cr.				5275.90	6262.90	2235.30	
31	32	Dept. A Purchases, Dr.							
31	35	Dept. B Purchases, Dr.							

Illustration 51, Purchases Journal for Controlling Accounts

Daily Posting from the Purchases Journal. Each amount entered in the Accounts Payable Ledger column is posted to the credit of the account in the accounts payable ledger written on the same line with it; this posting is daily. The illustration at the left shows the method of posting the first

JUDSON TWINE CO.					Ruston
Date	Explanation	F.	Debit	Credit	Balance
Mar. 22	24-3/10-n/30	P.1		627.50	

entry in the purchases journal to the accounts payable ledger ruled with a *Balance* column. With this form of ledger the date of each posting is

recorded at the left and debits and credits indicated through placing the amount in the appropriate column at the right. The Balance column is used only

at the end of the month and at that time the amount to be used on the Trial Balance is entered in this column. (See note on page 240.)

Posting the Purchases Journal Totals. At the end of the month the total of the Accounts Payable column is posted to the credit of the Accounts Payable account, the total of the Dept. A column to the debit of the Dept. A Purchases account and the total of the Dept. B column to the debit of the Dept. B Purchases account; each of these three accounts is in the general ledger. The posting of the totals of the purchases journal, Illustration 51, to the general ledger is shown in the illustration at the right.

ACCOUNTS PAYABLE									
					19				
					Mar.	1			
						31	P 234	✓	2534 80
									8498 10
DEPT. A PURCHASES									
19									
Mar.	31	P 234	6262	80					
DEPT. B PURCHASES									
19									
Mar.	31	P 234	2235	30					

Sales Journal. The sales journal, Illustration 52, contains a record of a part of the sales made by Wolfe & Marx during the month of March; the waved lines indicate an omission of a part of the record. Since two departments are maintained, three money columns are required (a) the amount of each sale, (2) the amount of the merchandise sold from Dept. A, and (3) the amount of merchandise sold from Dept. B. When a sale is made from one department, the amount entered in the Accounts Receivable column and the departmental sales column is the same; when a sale is made from the two departments,

SALES JOURNAL

March, 19--

DATE	L. F.	ACCOUNT DEBITED	ADDRESS	TERMS	SALE No.	ACCTS. REC. DR	DEPT. A. SALES CR.	DEPT. B. SALES CR.
3	✓	W. H. Blackburn	Oakland	2/10-7/10	101	517 20	517 20	
4	✓	Grayson Bros.		3/10-7/10	102	381 75		381 75
5	✓	L. J. Luttrell	Norfolk	2/10-7/10	103	188 65	188 65	
5	✓	Julius Kern		70-day	104	518 40	388 80	129 60
8	✓	Douglas Brown	1724 Broadway, City	2/10-7/10	105	316 50		316 50
27	✓	City Purchasing Dept.	City Hall	2/10-7/10	123	80 —	80 —	
29	✓	Drum & Cain	Mason	C.O.D.	124	204 75	136 50	68 25
29	✓	Sadler Print Shop	1086 Lynn St., City	2/10-7/10	125	121 50	121 50	
31	5	Accounts Receivable, Dr.				769 020		
31	28	Dept. A Sales, Cr.					4355 70	
31	30	Dept. B Sales, Cr.						3334 50

Illustration 52, Sales Journal for Controlling Accounts

the amount entered in the Accounts Receivable column should be the sum of the amounts entered in the two department columns.

Daily Posting from the Sales Journal. Each amount entered in the Accounts Receivable Ledger column is posted to the debit of the account in the accounts receivable ledger written on the same line with it; this posting is daily. The illustration at the left shows the method of posting the first entry

W. H. BLACKBURN				Oakland	
Date	Explanation	F.	Debit	Credit	Balance
19 Mar.	3 2 10-n-60	S 101	517.20		

in the sales journal to the accounts receivable ledger ruled with a *Balance* column. With this form of ledger the date of each posting is recorded at the

left and debits and credits indicated through placing the amount in the appropriate column at the right. The Balance column is used only at the end of the month and at that time the amount to be used on the Trial Balance is entered in this column. (See note on page 240.)

Posting the Sales Journal Totals. At the end of the month the total of the Accounts Receivable column is posted to the debit of the Accounts Receivable account, the total of the Dept. A column to the credit of the Dept. A Sales account and the total of the Dept. B column to the credit of the Dept. B Sales account; each of these three accounts is in the general ledger. The posting of the totals of the sales journal, Illustration 52, to the general ledger is shown in the illustration at the right.

ACCOUNTS RECEIVABLE					
19 Mar.	1 31	√	2152.40		
		S 235	7690.20		
DEPT. A SALES					
			19 Mar. 31	S 235	4355.70
DEPT. B SALES					
			19 Mar. 31	S 235	3334.50

Cash Record. Two separate journals are used for the cash record, (a) the cash receipts journal and (b) the check register. All cash received is recorded in the cash receipts journal and deposited in the bank. All cash payments are made by check and recorded in the check register. Payments of cash which involve less than \$5.00 are made with currency from the petty cash fund and recorded in the petty cash book which is supplementary to the check register.

Cash Receipts Journal. Illustration 53 contains a record of the cash received by Wolfe & Marx during March. Four amount columns are provided because an accounts receivable control is maintained and sales discount is allowed charge customers. When the account to be credited is in the general ledger, the amount is entered in the first column and when the account is in the

CASH RECEIPTS

March, 19--

DATE	ACCOUNT CREDITED	EXPLANATION	L F	GENERAL LEDGER CR.	ACCOUNTS RECEIVABLE CR.	SALES DISCOUNT DR.	NET CASH DR.
1	Balance	On hand		576581			576581
2	Grayson Bros.	Inv. 7/20, less dis.	✓		36501	730	35771
4	W. H. Seaman	Inv. 7/2, less dis. 5083.95	✓	576581	42765	855	449262
9	Dept. A Sales	Cash sales	28	250-			250-
27	Hanes & Watson	Inv. 7/7, less dis. 2745.85	✓	114241	32150	643	131527
29	Herling Mfg. Co.	Inv. 7/9, less dis.	✓		17405	348	17057
29	Drum & Cain	Account of C. O. D. sale	✓		50-		50-
29	Mills Grocery Co.	Inv. 7/27, less dis.	✓		11104	222	10882
31	Dept. A Sales	Cash sales 1718.35	28	37525			37525
31	Accounts Receivable, Cr.		5		364746		
31	Sales Discount, Dr.		57			7297	
31	Cash Dr. 6326.34 (12092.15-576581)		1				12092.15
Cash Proof, March 31, 19--							
Total March Receipts, Cash Receipts Journal				12092.15			
Less Total Payments, Check Register				10373.80			
Balance in Bank				1718.35			

Illustration 53, Cash Receipts Journal for Controlling Accounts

accounts receivable ledger, in the second column. When sales discount is involved, the amount with which the customer's account is to be credited is entered in the Accounts Receivable Ledger column and the amount of the discount, in the Sales Discount column. The net amount of cash received is entered in the fourth column; when no discount is involved, the amount entered in the first or second column will be the same as the amount entered in the fourth column. The method of recording transactions is the same as on the receipts side of the cash book illustrated on page 150, except two columns are provided for the amounts to be posted daily because two ledgers are used.

Bank Deposits. All cash received is deposited in the bank. At the time it is desired to make a deposit, the cash receipts journal is footed as illustrated, and proved. The sum of the amounts entered in the first and second columns less the sum of the amounts entered in the third column should equal the sum of the amounts entered in the fourth column. The amount of the deposit should be the difference between the sum of the amounts entered in the fourth column and the total entered when the previous deposit was made. In other

words, the net cash received as recorded in the fourth column should always equal the amount of cash deposited in the bank; at the end of the month, the total of the fourth column should agree with the total of the deposits.

Daily Posting of the Cash Receipts Journal. Each amount entered in the first column is posted to the credit of the account in the general ledger written on the same line with it. Each amount entered in the second column is posted to the credit of the account in the accounts receivable ledger written on the same line with it. The amounts entered in the third and fourth columns are not posted daily. The account in the illustration at the right shows the account in the accounts receivable ledger when the second entry in the cash receipts journal illustrated has been posted. The debit of this account was posted from the sales journal. (See note on page 240.)

GRAYSON BROS.					Riverside	
Date	Explanation	F.	Debit	Credit	Balance	
19						
Feb. 20	2/10-n/60	S 91	365 01			
Mar. 2		C 237		365 01		

Posting the Totals of the Cash Receipts Journal. At the end of the month the totals of the second, third and fourth columns are posted to the

CASH									
19									
Mar. 31	Bal.	√	5765 81						
	C 237		6326 84						
ACCOUNTS RECEIVABLE									
19									
Mar. 31	√	2152 40	19	Mar. 31	C 237	3647 46			
	S 235	7690 20							
SALES DISCOUNT									
19									
Mar. 31	C 237	72 97							

appropriate accounts in the general ledger as indicated by the title at the top of each column. The total of the first column is not posted because each amount entered in this column is posted daily. The accounts in the illustration at the left show the accounts in the general ledger after the totals of

the cash receipts journal, Illustration 53, have been posted.

Check Register. Illustration 54 contains a record of the checks issued by the firm of Wolfe & Marx during the month of March. The entries are made from the checks when issued. No stub is provided for each check since the information recorded in the check register is all that is necessary; the *For* column provides space for the purpose of each check and the name of the payee where it is different from the title of the account. The information in the *Check No.* and *Net Cash Paid* columns is sufficient for reconciliation of the bank account at the beginning of each month.

The amount columns provided are the same as those on the cash payments side of the cash book, page 151, except two columns are provided for

amounts to be posted daily because two ledgers are used. The title of each column indicates the ledger in which the account is maintained and to which the amounts recorded in the column are to be posted.

CHECK REGISTER									
March									
DATE	CHECK NO.	ACCOUNT DEBITED	FOR	L. F.	GENERAL LEDGER DR.	ACCOUNTS PAYABLE DR.	PURCHASES DISCOUNT CR.	NET CASH CR.	
1	101	Rent Expense	R. E. Co. March rent	47	350--			350--	
2	102	Postage	Stamps	13	100--			100--	
2	103	Utility Cash	U. S. Fund	2	25--			25--	
4	104	Supplies	Supplies	1	100--			100--	
5	105	Judson, Wm. Co.	Inv. 7/25, less 3%	✓		52750	1883	60867	
6	106	Partner Salaries	Payroll	37	90--			90--	
6	107	Divers. Charges	Payroll	37	65--			65--	
6	108	Office Salaries	Payroll	48	120--	52750	1883	162266	
8	109	Freight vs. Pay In	U. S. Co. bill 3/31	32	49186	52725	527	52198	
9	110	American Prod. Co.	Inv. 7/25, less 3%	✓		124255	4970	119285	
12	111	Freight vs. Pay In	U. S. Co. bill 3/31	32	240--			240--	
12	112	Freight vs. Pay In	U. S. Co. bill 3/31	✓		1127--	4508	108192	
27	122	Brown, Wm. Co.	Inv. 7/25, less 3%	✓		42865	857	42008	
27	123	Partner Salaries	Payroll	38	90--			90--	
27	123	Divers. Charges	Payroll	37	65--			65--	
27	123	Office Salaries	Payroll	48	120--	51200	1622	162066	
27	124	American Prod. Co.	Inv. 7/25, less 3%	✓		78473	2465	76028	
31	125	Freight vs. Pay In	U. S. Co. bill 3/31	32	49186			49186	
31	126	Partner Salaries	Payroll	49	500--	640533	1887	500--	
					415736				
31		Accounts Payable, Cr.		24		640533			
31		Purchases Discount, Cr.		55			1887		
31		Cash, Cr.		1				1037380	

Illustration 54, Check Register for Controlling Accounts

Proving the Check Register. The amounts recorded in the check register may be proved to be correct in the same manner as the amounts recorded in the cash receipts journal. The sum of the amounts recorded in the first and second columns less the sum of the amounts entered in the third column should equal the sum of the amounts entered in the fourth column. This proof should be effected at the time each deposit is made and the cash balance proved to be correct.

Cash Proof. Cash is proved periodically and always previous to making deposits. The sum of the Net Cash column in the cash receipts journal less the sum of the Net Cash column in the check register should equal the amount of cash in the bank and in the safe available for deposit. The amount

of cash in the bank is the difference between the total of the Net Cash column in the cash receipts journal at the time of the previous deposit and the total of the Net Cash column in the check register at the present time. The amount to be deposited added to the amount in the bank should be the same as the cash balance. When all cash on hand has been deposited, the balance shown by the cash record and the amount of cash in the bank should be the same.

When the cash receipts are recorded by one clerk and the cash payments by another, the cash proof is usually made by the one who records the cash receipts. A form of cash proof similar to that at the bottom of Illustration 53 may be used for proving cash during the month and the cash proof at the end of the month may be shown at the conclusion of the cash receipts record as in the illustration; the cash proof form is shown in the cash receipts journal only at the end of the month.

Daily Posting from the Check Register. Each amount entered in the first column is posted to the debit of the account in the general ledger written on the same line with it. Each amount entered in the second column is posted to the debit of the account in the accounts payable ledger written on the same line with it. The amounts entered in the third and fourth columns are not posted daily. The account in the illustration at the right shows the account in the accounts payable ledger when the fifth entry in the check register illustrated has been posted. The credit in this account was posted from the purchases journal.

JUDSON TWINE Co.					Ruston	
Date	Explanation	F.	Debit	Credit	Balance	
19 Mar. 25	22/24-3/10-n/30 P	1 C 239	627 50	627 50		

Posting the Check Register Totals. At the end of the month the totals

CASH									
19 Mar. 1	Bal.	✓	5765 81	19 Mar. 31	C 239	10373 80			
	C 237		6326 34						
ACCOUNTS PAYABLE									
19 Mar. 31	C 239	✓	6405 33	19 Mar. 1		2534 80			
					P 234	8498 10			
PURCHASES DISCOUNT									
19 Mar. 31	C 239		188 89						

of the second, third and fourth columns are posted to the appropriate accounts in the general ledger as indicated by the title at the top of each column. The total of the first column is not posted because each amount entered in this column is posted daily. The accounts in the illustration at the left show the

results of posting the totals of the check register, Illustration 54, to the accounts in the general ledger.

NOTE.—In the illustrations which relate to the daily posting from the purchases journal, sales journal, check register and cash receipts journal, check marks are shown in the folio column of each journal to indicate posting to the accounts with customers and creditors. It is assumed that loose-leaf ledgers are used for the two subsidiary ledgers, hence there are no pages to enter in the folio columns of the journals.

Petty Cash Fund. When all cash received is deposited and all payments made by check, it is necessary to provide some means of making payment of small amounts of cash. The usual plan is to withdraw an amount of cash from the bank, keep this on hand in the safe and make the small payments from it; this is referred to as the *petty cash fund*.

When the plan suggested is followed, the amount of the check withdrawn to establish the petty cash fund is debited to an account in the general ledger with Petty Cash Fund. The amount withdrawn will depend entirely upon the nature of the small payments required; usually \$25.00 or \$50.00 is considered sufficient for the petty cash fund. The petty cash fund is kept in a drawer of the safe and payments are made from it; the usual plan is to pay from the petty cash fund amounts which are less than \$5.00, amounts of \$5.00 or more being paid by check.

Records for Petty Cash Fund. A record is made of the expenditures from the petty cash fund in a petty cash book provided for this purpose. The record in this petty cash book, however, does not become a part of the general accounting records until the fund is renewed or it is desired to record the expenditures at the close of the fiscal period.

Each expenditure from the petty cash fund is recorded in the petty cash book as a debit to the appropriate expense account. When it is necessary to renew the fund, a check is issued for the total expenditures and recorded in the check register as a debit to the appropriate expense accounts; the titles of these expense accounts are obtained from the record in the petty cash book. The check required to renew the petty cash fund will be the amount of the expenditure, hence recording this check in the check register provides a basis for the amount recorded as a debit to the one or more expense accounts.

The illustration below contains a record of the expenditures from the petty cash fund established by Wolfe & Marx March 1. The expenditures during

PETTY CASH BOOK

DATE	ACCOUNT DEBITED	EXPLANATION	PAYMENTS	RECEIPTS
Mar 2	Check No. 103			25 —
10	Office Salaries	Miss Quice Diehl, 1 day	4 50	
16	Mrs. General Expense	Ad. B. L. Council program	2 —	
18	Mrs. General Expense	Trans. for Mrs. Marx	75	
21	Store Supplies	2.5 lb. Special wine @ 15¢	3 75	
27	Postage	Postal cards	5 —	
31	Balance		9 —	
			25 —	25 —
Apr 1	Balance			9 —

Illustration 55, Petty Cash Book

March were not sufficient to justify renewing the fund at the close of the fiscal period, hence they were recorded through an entry in the general journal; see last entry in Illustration 57, page 243.

The one in charge of the petty cash fund will require a receipt for each expenditure, hence the petty cash drawer in the safe will contain at all times currency and receipts equal to the amount of the established fund. When the fund is renewed, the receipts are filed permanently.

Journal Voucher. A purchases invoice provides a basis for each entry in the purchases journal, the sales invoice for the sales journal, a check or currency for the cash receipts journal, and the check issued for the check register. In other words, a definite form of voucher provides a basis for the entry in each journal except the general journal.

Some of the entries in the general journal are made from vouchers while others are required because of adjustments. A *journal voucher* is a definite voucher form provided for each entry in the general journal. These vouchers are numbered consecutively and filed numerically. The general journal contains a summary of the information in each of these vouchers for daily and monthly posting. Opening and closing entries may be posted from the journal voucher, if desired, as they affect only the general ledger columns in the general journal. The illustration below shows journal voucher No. 179 referred to in the general journal, Illustration 57, page 243.

WOLFE & MARX JACKSON, MICH.		VOUCHER No. 179	
Journal Voucher			
Approved for Entry <u>W. O. Day General Auditor</u>		Date <u>March 3, 19</u>	
Entered by <u>J. M. Allen</u>		Journal Folio <u>1</u>	
Debit:	Notes Receivable	396	48
	Interest Income	2	71
Credit: Julius Kern		399	19
Explanation: Received from Julius Kern a 3-months 6% interest-bearing note for \$396.48, dated January 21, at its present value to apply on account.			

Illustration 56, Journal Voucher

The record of this voucher in the general journal provides all the information needed for posting to the ledger. The number of the voucher is the only explanation required in the general journal entry.

The journal vouchers are prepared by the chief accountant or an assistant. The journal voucher prepared for an adjustment should be signed by the one authorized to make the adjustment; this applies only to those adjustments which are not represented by business forms such as credit memorandums.

General Journal. Illustration 57 is a general journal which contains a record of the transactions of a general nature completed by Wolfe & Marx during the March fiscal period. The transactions recorded in this journal include only those which cannot be recorded in one of the four special journals described in the preceding discussion.

The general journal illustrated is a summary of the journal vouchers issued during March as explained on the preceding page. Since accounts receivable and accounts payable controls are maintained, six money columns are necessary, one for debits and one for credits in each of the three ledgers.

The general journal illustrated contains eight entries; the waved lines indicate the omission of a number of entries. The indentation of the account title or titles credited separates each entry. The first entry is a summary of the journal voucher illustrated on page 242; each of the other entries is a summary of the journal voucher prepared in a similar form.

Check marks are used to indicate posting to the subsidiary ledgers which are loose leaf. When an amount is not to be posted, "N. P." (not posted) is written in the folio column. See first entry in the cash receipts journal, page 237.

Posting the General Journal. The amounts entered in each debit or credit ledger column are posted daily or frequently during the month. The title written at the top of each double column indicates the ledger in which the account is maintained. The folio column is placed at the right of the account title for convenience when posting; this arrangement is more efficient in a journal containing many money columns.

At the end of the month the total of the Accounts Receivable Ledger columns and the Accounts Payable Ledger columns are posted to the debit and credit of the Accounts Receivable and the Accounts Payable accounts in the general ledger. The totals of the General Ledger columns are not posted because each amount in these columns has already been recorded in the general ledger.

The illustration at the right shows the method of posting the Accounts Receivable and Accounts Payable Ledger columns, Illustration 57, page 243, at the close of March. The

Accounts Receivable and Accounts Payable accounts illustrated contain the balance of these accounts at the beginning of the month and the posting from the other journals during the month as illustrated in previous post-

ings. In other words, the balance of each of these general ledger accounts should be the sum of the balances of the accounts in the ledger which the account controls.

ACCOUNTS RECEIVABLE									
19					19				
Mar.	1			2152 40	Mar.	31	C 237	3647 46	
	31	S 235	7690 20			31	J 243	949 09	
	31	J 243	32 40						
ACCOUNTS PAYABLE									
19					19				
Mar.	31	C 239	6405 33		Mar.	1		2534 80	
	31	J 243	194 62			31	P 234	8498 10	
						31	J 243	41 50	

Purchases Returns Journal. Returned purchases and allowances may be recorded in the general journal as shown in Illustration 57 on page 243 but in accounting for departmental gross profit on sales where there are a number of departments, it is customary to provide a columnar record for purchases returns and allowances. The title of this record may be *purchases returns and allowances journal* or *purchases returns and allowances register*. The ruling of the purchases returns and allowances journal or register is the same as the purchases journal. The illustration below shows the ruling for a purchases returns and allowances register which, as you will observe, is similar to the purchases journal, Illustration 51, page 234.

Date	L. F.	Account Debited	Address	Cr. Memo. No.	Accounts Payable Dr.	Dept. A Pur. Returns Cr.	Dept. B Pur. Returns Cr.

The record in the purchases returns and allowances register is made from the original memorandum received from the creditor. These credit memorandums are numbered consecutively and the number used instead of the page when posting to the account with the creditor.

The entries in the purchases returns and allowances register are posted daily or frequently during the month to the debit of the appropriate accounts in the accounts payable ledger. At the end of the month the totals of the two credit columns should equal the total of the debit column. The total of the first column is posted to the debit of the Accounts Payable control account in the general ledger. The totals of the second and third columns are posted to the credit of the departmental accounts as indicated by the title of the column.

Sales Returns and Allowances Journal. Returned sales and allowances may be recorded in the general journal as shown in Illustration 57 on page 243 but in accounting for departmental gross profit on sales where there are a number of departments, it is customary to provide a columnar record for sales returns and allowances. The title of this record may be *sales returns and allowances journal* or *sales returns and allowances register*. The ruling of the sales returns and allowances journal or register is the same as the sales journal. The illustration below shows the ruling for a sales returns and allowances register which, as you will observe, is similar to the sales journal, Illustration 52, page 235.

Date	L. F.	Account Credited	Address	Cr. Memo. No.	Accounts Rec. Cr.	Dept. A Sales Returns Dr.	Dept. B Sales Returns Dr.

The record in the sales returns and allowances register is made from the copy of the credit memorandum sent the customer. These credit memorandums are numbered consecutively and the number used instead of the page when posting to the account with the customer.

The entries in the sales returns and allowances register are posted daily or frequently during the month to the credit of the appropriate accounts in the accounts receivable ledger. At the end of the month, the totals of the two debit columns should equal the total of the credit column. The total of the first column is posted to the credit of the Accounts Receivable control account in the general ledger. The totals of the second and third columns are posted to the debit of the departmental accounts indicated by the title of the column.

REPORTS

Complete Reports Nos. 59 and 60 in the work book and present for approval. You will follow the instructor's directions regarding completion of the Part III Practice Set.

CHAPTER XX

WORK AT THE CLOSE OF A FISCAL PERIOD

Work of a specific nature is required of the accountant at the close of the fiscal period. This work is explained in Chapters VI and XIII. The discussion in this chapter provides a review of the work at the close of the fiscal period outlined in the two earlier chapters. The ledger resulting from posting the books of original entry illustrated in Chapter XIX is used as the basis for the discussion and illustrations in this chapter.

Charting Accounts. At the time a business is organized, the accountant will determine from the nature of the assets required in the proposed operations of the business the accounts needed to record the changes in assets, liabilities and proprietorship. A list of the accounts that will be required in connection with the operations of the business is referred to as a *chart of accounts*.

As explained in preceding discussions, the changes in each asset, each liability and in the proprietorship is recorded in account form, a separate account being provided for the record of each asset, each liability and each change in proprietorship. For the reason stated in the preceding sentence, a chart must provide for the number of accounts needed to record the changes in assets, liabilities and proprietorship.

A chart of the accounts prepared by the accountant for the firm of Wolfe & Marx, the wholesale paper merchants referred to in the preceding chapter, is shown on page 248.

Classification of Accounts. The asset and liability accounts are classified according to the nature of the assets and liabilities. The income and expense accounts are classified according to the nature of the income and expense and the relation between the two. The classification in the chart is briefly explained in the paragraphs below and on pages 248, 249, and 250.

Current Assets include accounts with Cash and the other assets which will soon become cash through the usual operations of the business. Thus, notes receivable and accounts receivable are regarded as current assets because they will both become cash through collection. The merchandise inventory is also a current asset because this will soon become cash either through cash sales or through sales on account and collections. Accrued Interest on Notes Receivable is also included with the current assets because it contains a record of the increases in the value of interest-bearing notes receivable which is recorded at the close of the fiscal period.

CHART OF ACCOUNTS

WOLFE & MARX

ASSETS

CURRENT ASSETS

Cash
 Petty Cash
 Notes Receivable
 — Notes Receivable Discounted*
 Accrued Interest on Notes Receivable
 Accounts Receivable
 — Reserve for Bad Debts*
 Dept. A Inventory (ending)
 Dept. B Inventory (ending)

DEFERRED ASSETS

Store Supplies
 Delivery Supplies
 Catalogs and Price Lists
 Office Supplies
 Postage
 Prepaid Insurance
 Prepaid Interest on Notes Payable

FIXED ASSETS

Store Equipment
 — Dep. Reserve for Store Equip.*
 Delivery Equipment
 — Dep. Reserve for Delivery Equip.*
 Office Equipment
 — Dep. Reserve for Office Equip.*

LIABILITIES

CURRENT LIABILITIES

Notes Payable
 Accrued Interest on Notes Payable
 Accounts Payable
 Accrued Wages

FIXED LIABILITIES

Mortgage Payable

PROPRIETORSHIP

H. A. Wolfe, Capital
 — H. A. Wolfe, Drawing†
 M. J. Marx, Capital
 — M. J. Marx, Drawing†

TRADING

INCOME FROM SALES

Dept. A Sales
 — Dept. A Sales Returns and Allowances†
 Dept. B Sales
 — Dept. B Sales Returns and Allowances†

COST OF SALES

Dept. A Inventory (beginning)
 Dept. A Purchases
 Dept. A Freight and Drayage In
 — Dept. A Purchases Returns and Allow.*
 Dept. B Inventory (beginning)
 Dept. B Purchases
 Dept. B Freight and Drayage In
 — Dept. B Purchases Returns and Allow.*

OPERATING EXPENSES

SELLING

Store Salaries
 Advertising Expense
 Drivers Wages
 Store Supplies Used
 Delivery Supplies Used
 Catalogs and Price Lists Used
 Expired Insurance on Merchandise
 Expired Insurance on Del. & Store Equip.
 Depreciation on Store Equipment
 Depreciation on Delivery Equipment
 Miscellaneous Selling Expense

GENERAL

Rent Expense
 Office Salaries
 Partners Salaries
 Office Supplies Used
 Postage Used
 Expired Insurance on Office Equipment
 Depreciation on Office Equipment
 Loss on Bad Debts
 Miscellaneous General Expense

NON-OPERATING INCOME

NON-OPERATING INCOME

Purchases Discount
 Interest Income

NON-OPERATING EXPENSE

NON-OPERATING EXPENSE

Sales Discount
 Interest Expense

*An account containing a credit which would have been posted to an asset or cost account if the additional information provided by the separate account had not been required. Usually referred to as a minus asset or minus cost account.

†An account containing a debit which would have been posted to an income or proprietorship account if the additional information provided by the separate account had not been required. Usually referred to as a minus income or minus proprietorship account.

Deferred Assets are assets either in the form of property or prepaid services usually referred to as *deferred charges*. They are described as deferred charges because they will become expenses in a short time through the usual operations of the business. The chart of accounts includes an expense account for the expense resulting from the use of the deferred charge but as explained on page 92, these expenses may be recorded direct in the Profit and Loss account at the close of the fiscal period.

Fixed Assets include property purchased for use in the business but which will be of service for a number of fiscal periods. Fixed assets are usually distinguished from deferred charges through the length of service and the fact that the fixed asset will remain the same in form as long as it is of service to the business. Fixed assets and deferred charges both eventually become expenses through use but the deferred charges will be consumed usually in the next fiscal period while the fixed assets will be of service a number of fiscal periods usually a number of years. The chart of accounts includes expense accounts in which to record the estimated depreciation on the fixed assets at the close of the fiscal period.

Current Liabilities include those debts which will be due in a short time usually the next fiscal period. There are two forms of liabilities, oral and written, known in accounting as accounts payable and notes payable. The accrued interest on interest-bearing notes payable is also a current liability, hence when recorded at the close of the fiscal period the account in which it is recorded is included in the current liability classification.

Fixed Liabilities include written promises to be paid over a period of years. Thus, a mortgage payable is a written promise to pay a part of the purchase price of real estate over a term of years.

Proprietorship. The chart was prepared for a business owned by two partners, hence the Capital and Drawing accounts are both included in the chart. According to the articles of copartnership Drawing accounts will not be needed because the partners are not authorized to withdraw profits in advance. However, the partners may agree to do this, hence when preparing the chart the accountant included the Drawing accounts. As explained in a previous discussion, the Capital account with each partner contains a record of the increases and decreases in his investment which includes his share of the profit or loss. The Drawing account contains a record of the assets withdrawn during the fiscal period in anticipation of the profit earned as a result of the operations for the period. The balance of the Drawing account is usually closed into the Capital account at the end of the fiscal period.

Trading. The usual income of a mercantile business is the profit resulting from selling merchandise at a price greater than the cost. It is referred to as the trading profit or operating income. The accounts which contain a record of the trading profit are referred to as the trading accounts and ar-

ranged in two groups, (a) those which contain a record of the sales, and (b) the cost of merchandise sold.

In the chart on page 248, the first division of the trading accounts contains the accounts which show a record of the sales and the sales returns and allowances; the latter are referred to as minus income accounts. The accounts which contain a record of the cost of sales include the beginning inventory, the purchases during the period, the freight cost and the deductions from purchases because of returns and allowances. The accounts which show returns and allowances are referred to as minus cost accounts.

Expenses. Certain expenses are necessary in order to earn the income. Each expense is a decrease in proprietorship to be deducted from income which is an increase in proprietorship. When charting the accounts, the accountant usually divides the expenses into two classes, referred to as *selling expenses* and *general expenses*.

An account is provided with each expense of a specific nature; small items which cannot be classified are recorded in a Miscellaneous Expense account in each group. The debits and credits to the separate accounts are the same as to the one Expense account.

Selling Expenses. Expenses which are necessary to make sales are regarded as selling expenses. It is sometimes difficult to distinguish between selling and general expenses. Usually those expenses which are reduced or increased according to the volume of the sales are referred to as selling expenses and all others, as general expenses. The chart of accounts on page 248 shows the type of expenses usually classified as selling expenses.

General Expenses. Expenses which are not directly related to sales are regarded as general expenses. As stated in the preceding paragraph, it is sometimes difficult to distinguish between selling and general expenses. The chart of the accounts on page 248 shows the type of expenses usually classified as general expenses.

Non-operating Income. Income is an increase in proprietorship resulting from an increase in assets without a corresponding decrease in some other asset. Operating income includes that resulting from the sale of commodities in which the business deals. Non-operating income usually includes purchases discount, interest income and other profits which are not the direct results of sales.

Non-operating Expense is sometimes referred to as *deductions from income*. It includes decreases in proprietorship or expenses which may or may not occur in each fiscal period but which are not directly related to sales or the operations of the office. Sales discount and interest expense are the usual non-operating expenses.

REPORT

Complete Report No. 61 in the work book and present for approval. Continue with the text discussion until Report No. 62 is required on page 256.

Accounting Process. As a result of operating the business, changes occur in assets, liabilities and proprietorship. The purpose of the accounting records is to provide a record of these changes through account balances which may be used as a basis for proving the count of the assets and liabilities required at the time it is desired to ascertain proprietorship and net profit. Each change in assets, assets and liabilities or assets and proprietorship is recorded (a) at the time it occurs, or (b) at the close of the fiscal period. When the changes in assets or assets and liabilities are not recorded at the time they occur, it is necessary to record them at the close of the fiscal period if the asset and liability account balances are to be used as a basis for proving the count.

Reports Prepared by the Accountant at the Close of a Fiscal Period.

At the close of each fiscal period, the accountant prepares two reports, one containing information regarding assets, liabilities and proprietorship and the other, gross profit, expenses and net profit. The account balances are used as a basis for these reports. Before preparing the reports, it is customary to count certain assets and compare the results of the count with the account balances. The assets usually counted at the close of the fiscal period are cash, notes receivable, merchandise inventory, deferred charges and fixed assets. It is not necessary to count the accounts receivable, accounts payable and notes payable because if the records are correct as indicated by the Trial Balance being in balance, the accountant can secure the desired information regarding the amount of each of these assets and liabilities from the records.

At the close of each fiscal period, the accountant will receive from the clerks in the various departments a count of the following assets: merchandise inventory, deferred charges, fixed assets. He ascertains through count the amount of the assets cash, notes receivable, accrued interest on notes receivable, the amount of the liabilities notes payable and accrued interest on notes payable, and the prepaid interest on notes payable. From the information provided him by the clerks, that secured from his own count and through the proof provided by the Trial Balance, the accountant can ascertain the present proprietorship, net profit and proof of their correctness; this proof is effected through the Work Sheet.

The information obtained by the accountant for Wolfe & Marx at the close of the March fiscal period from the reports of the clerks and from his own count is given in the list below. The italic type indicates the items on which the accountant made the count.

<i>Cash</i>	\$1,718.35	Postage.....	110.65
<i>Notes Receivable</i>	1,433.23	<i>Prepaid Insurance</i>	217.69
<i>Accrued Interest on Notes Rec.</i> ...	5.22	<i>Prepaid Interest on Notes Pay.</i> ...	15.00
Dept. A Inventory.....	11,735.06	Store Equipment.....	550.00
Dept. B Inventory.....	15,378.83	Delivery Equipment.....	1,660.00
Store Supplies.....	141.70	Office Equipment.....	1,950.00
Delivery Supplies.....	34.20	<i>Notes Payable</i>	7,000.00
Catalogs and Price Lists.....	205.00	<i>Accrued Interest on Notes Payable</i>	25.83
Office Supplies.....	114.75		

Work Sheet. Illustration 58, page 253, shows the Work Sheet prepared by the accountant for Wolfe & Marx. The purpose of the Work Sheet is to ascertain present proprietorship, net profit and proof of their correctness before reporting these facts to the partners.

Ten columns are provided; (a) two for the March 31 Trial Balance, (b) two for the adjustments because some of the changes in assets have not been recorded, (c) two for summarizing the trading accounts in order to ascertain the gross profit on sales in each department, (d) two for the accounts which show an expense or income, and (e) two for the accounts which show an asset, liability or proprietorship. The Adjustments columns would not be required if the changes in assets had been recorded at the time each change occurred.

The changes in assets and liabilities and the corresponding changes in proprietorship to be recorded at the close of the fiscal period in the Adjustments columns are necessary because the following changes were not recorded at the time they occurred.

- (1) The increase in the asset accrued interest on notes receivable and the corresponding increase in proprietorship.
- (2) The decrease in the asset accounts receivable because of the estimated amount that will not be collected from charge customers.
- (3) The decrease in the assets store supplies, delivery supplies, catalogs and price lists, office supplies, postage, and prepaid insurance because of use or lapse of time.
- (4) The increase in the asset prepaid interest on notes payable because interest was paid in advance, that is, beyond the close of the fiscal period.
- (5) The decrease in the fixed assets store equipment, delivery equipment and office equipment and the corresponding decrease in proprietorship.
- (6) The increase in the liability accrued interest on notes payable and the corresponding decrease in proprietorship.
- (7) The increase in the liability accrued wages because the last pay day was March 27 and the next pay day will not occur until February 3, hence there is three days wages due each employee.

You must keep in mind the fact that there is no mystery about the use of the Adjustments columns; it is a necessity brought about by the fact that changes in assets and liabilities were not recorded at the time the changes occur, hence must be recorded at the close of the fiscal period. Definite facts are used by the accountant as a basis for the entries; they are not imaginary amounts invented by someone to make trouble for the accountant.

Extensions and Verification of the Work Sheet. The Trading columns contain the debit and credit balances of the trading accounts including the merchandise inventory, March 31, for Department A and for Department B. The sum of the merchandise inventory at the close of the fiscal period and the

Wolfe & Marx Work Sheet, March 31, 19-

NAME OF ACCOUNT	TRIAL BALANCE		ADJUSTMENTS		TRAFFIC		P. & L. STATEMENT		BALANCE SHEET	
	DR	CR	DR	CR	DR	CR	EXP	REVENUE	ASSETS	LIAB. & PROP.
Private										
Petty Cash	7.25								17.25	
Int. Receivable	9-									
Investment on Notes Recd				322						
Accounts Receivable	527845								527845	
Reserve for Bad Debts					4224					
Prepaid Insurance	240-									
Store Supplies	26810					1487855/1537854			1537884	
Office Supplies	160				12440				14101	
Catalogs & Price Lists	240				6380				3420	
Office Supplies	17925				35-				205-	
Postage	14125				6450				11475	
Prepaid Insurance	240-				3060				11065	
Rebated on Int. Note & Pay.					223				21769	
Dep. Res. for Store Equip.		3850							550-	
Delivery Equipment	1660-				275					4125
Dep. Res. for Del. Equip.		4266			3458				1660-	
Dep. Res. for Equip.		3453								46124
Int. Payable		7000-			673					14025
Accrued Int. on Notes Pay.					2583				7000-	
Accrued Wages					13750				2583	
M. A. Wolff, Capital	1373925									447445
M. J. Mason, Capital	1373925									13750
Int. on Capital										1373925
Int. on Notes Pay.										17125
Int. on Equip.		345950				345950				
Int. on Equip.										
Dept. A Purchases	626280				626280					
Dept. A. B. & Drapage in	73392				73392					
Dept. A. B. Res. & Allow.		100-				100-				
Dept. B Purchases	223330				223330					
Dept. B. Res. & Allow.		5780				5780				
Store Salaries	360-				45-				405-	
Store Wages	260-				3250				2720	
Store Supplies Used					12640				240-	
Store Supplies Used					1500				1580	
Int. on Equip. & Price Lists Used					35-				35-	
Int. on Equip. & Price Lists					775				775	
Int. on Equip. & Price Lists					1456				1456	
Int. on Equip. & Price Lists					28				75	
Int. on Equip. & Price Lists					3403				3403	
Int. on Equip. & Price Lists					35				35-	
Int. on Equip. & Price Lists					4425				4425	
Int. on Equip. & Price Lists					1000				1000	
Int. on Equip. & Price Lists					1400				1400	
Int. on Equip. & Price Lists					240				240	
Int. on Equip. & Price Lists					775				775	
Int. on Equip. & Price Lists					1456				1456	
Int. on Equip. & Price Lists					28				75	

trading accounts with a credit balance less the merchandise on hand at the beginning of the fiscal period and the trading accounts with a debit balance is the gross profit on sales. The usual account balances which provide trading information are Sales, Purchases, Freight and Drayage In, Purchases Returns and Allowances, Sales Returns and Allowances and Merchandise Inventory; the Merchandise Inventory account contains the beginning inventory, the amount of the closing inventory being ascertained by count.

WOLFE & MARX

BALANCE SHEET, MARCH 31, 19..

ASSETS		
Current Assets:		
Cash	1718.35	
Petty Cash	9.00	
Notes Receivable	1433.23	
Accrued Interest on Notes Receivable	5.22	
Accounts Receivable	5278.45	
Less Reserve for Bad Debts	42.20	5236.25
Dept. A Inventory		11735.06
Dept. B Inventory		15378.84
Total Current Assets		35515.95
Deferred Charges:		
Store Supplies	141.70	
Delivery Supplies	34.20	
Catalogs and Price Lists	205.00	
Office Supplies	114.75	
Postage	110.65	
Prepaid Insurance	217.69	
Prepaid Interest on Notes Payable	15.00	
Total Deferred Charges		838.99
Fixed Assets:		
Store Equipment	550.00	
Less Depreciation Reserve	41.25	508.75
Delivery Equipment	1660.00	
Less Depreciation Reserve	461.24	1198.76
Office Equipment	1950.00	
Less Depreciation Reserve	146.25	1803.75
Total Fixed Assets		3511.26
TOTAL ASSETS		39866.20
LIABILITIES		
Current Liabilities:		
Notes Payable	7000.00	
Accrued Interest on Notes Payable	25.83	
Accounts Payable	4474.45	
Accrued Wages	137.50	
TOTAL LIABILITIES		11637.78
PROPRIETORSHIP		
H. A. Wolfe's Capital, March 1	13739.25	
Add Net Profit for March	374.96	14114.21
M. J. Marx's Capital, March 1	13739.25	
Add Net Profit for March	374.96	14114.21
TOTAL PROPRIETORSHIP		28228.42

Illustration 59, Balance Sheet

Each increase in proprietorship (income) and each decrease in proprietorship (expense) is recorded in an account with an appropriate title. The balance of these accounts are extended into the Profit and Loss Statement columns. The gross trading profit in each department is also extended from the Trading column into the Profit and Loss Statement column.

The sum of the increases in proprietorship (income) minus the sum of the decreases in proprietorship (expense) is the net increase in proprietorship. The net increase in proprietorship is extended into the Liabilities column because the sum of the assets should equal the sum of the liabilities and the proprietorship. When the sum of the Liabilities column, which includes (a) the liabilities, (b) the balance of the Capital accounts, and (c) the net profit, equals the assets and the sum of the expenses plus the net profit equals the income, the accountant knows that his Work Sheet is correct.

Balance Sheet. A list of the assets, liabilities and proprietorship is referred to in accounting as the *Balance Sheet*. Illustration 59, page 254, shows the Balance Sheet prepared by the accountant for Wolfe & Marx, March 31. The Balance Sheet columns of the Work Sheet are used as a basis for preparing this Balance Sheet.

The information on the Balance Sheet is classified according to the chart of the accounts illustrated on page 248. This classification will be of assistance to each partner because he can ascertain from it whether there is sufficient current assets to pay the current liabilities and whether the inventories are consistent with the amount of goods that should be carried in stock.

Abstracts. A list of the accounts in the accounts receivable ledger is referred to as a schedule or abstract of accounts receivable and a list of the accounts in the accounts payable ledger, as a schedule or abstract of accounts payable. The illustration below shows the list prepared from the accounts receivable ledger of Wolfe & Marx at the close of the fiscal period, March 31.

SCHEDULE OF ACCOUNTS RECEIVABLE, MARCH 31, 19

Grayson Bros.....	March 4, 3/30-n/90.....	381.75
Julius Kern.....	Balance.....	23.56
Burr Bros.....	Balance.....	1038.74
Douglas & Brown.....	March 8, 3/30-n/90.....	302.00
Butler & Cruze.....	March 15, 3/30-n/90.....	315.45
Cotter Press.....	March 15, 3/30-n/90 455.25, frt. 32.40.....	487.65
Bank & Bank.....	March 19, 3 30-n 90.....	415.25
Walter Davis Co.....	March 22, 3/10-n/30.....	416.40
W. H. Ingram.....	March 22, 2/10-n/60.....	316.45
J. A. Bird.....	March 23, 3, 30-n, 90.....	416.45
Carpenter & Brown.....	March 23, 3/30-n/90.....	298.45
Stewart Bros.....	Balance, C. O. D.....	60.00
Stubbs & Stubbs.....	March 25, 2/10-n/60.....	322.50
Union Press.....	May 15, 2/10-n/30.....	127.55
City Purchasing Dept.....	May 10 net.....	80.00
Drum & Cain.....	Balance, C. O. D.....	154.75
Sadler Print Shop.....	March 29, 2/10-n/60.....	121.50
		5278.45

Illustration 60, Abstract of Accounts Receivable

An abstract of accounts payable is shown below. The totals of the abstracts agree with the Accounts Receivable and Accounts Payable accounts shown on the Balance Sheet, page 254.

SCHEDULE OF ACCOUNTS PAYABLE, MARCH 31, 19

Case Manufacturing Co.	April 1, 2/10-n/30.	948.75
Jamaica Fiber Co.	March 2, 2/30-n/60.	318.80
Peters Drinking Cup Co.	April 15, 3/10-n/60.	718.45
James H. Watson Co.	April 1, 1/10-n/30.	237.50
Dempsey Paper Co.	March 23, 2/10-n/30 514.30, frt. 41.50	555.80
James Manufacturing Co.	March 25, 1/10-n/30.	563.85
Mead Paper Co.	March 27, 2/10-n/30.	855.40
Standard Paper Co.	April 1, 1/10-n/30.	275.90
		4474.45

Illustration 61, Abstract of Accounts Payable

Profit and Loss Statement. A list of the increases and decreases in proprietorship usually referred to as income and expenses is known in accounting as the Profit and Loss Statement; some accountants refer to it as the Income and Expense Statement. The title used to describe the report is not essential but the information which it contains should always be the increases in proprietorship, decreases in proprietorship, and net profit.

Illustration 62, page 257, shows the Profit and Loss Statement prepared by the accountant for Wolfe & Marx at the close of the fiscal period, March 31. The information is obtained from the Profit and Loss columns of the Work Sheet and the chart of accounts.

REPORT

Complete Report No. 62 in the work book and present for approval. Continue with the text discussion until Report No. 63 is required on page 264.

Adjusting Entries. Those entries necessary to record at the close of the fiscal period the changes in assets, liabilities and proprietorship which are not recorded at the time the changes occur are referred to in accounting as adjusting entries. These unrecorded changes are given consideration in the preparation of the Work Sheet, hence the Adjustments columns of the Work Sheet provide a basis for the adjusting entries.

The general journal, Illustration No. 63, page 258, contains a record of the adjusting entries required at the close of the fiscal period. The Adjustments columns of the Work Sheet, Illustration 58, page 253, were used as a basis for the entries. The purpose of these entries in the order in which they appear in the illustration is briefly described as follows:

The first entry is to record the accrued interest; the second, the reserve for loss on bad debts; the third, the various types of supplies used; the fourth, the expired insurance; the fifth, the prepaid interest on notes payable; the sixth, the depreciation on fixed assets; and the seventh and eighth, the accrued liabilities consisting of accrued interest on notes payable and accrued wages.

(Continued on page 259)

WOLFE & MARX

PROFIT AND LOSS STATEMENT FOR MONTH ENDING MARCH 31, 19..

	Dept. A		Dept. B	
Merchandise Sales:				
Gross Sales.	4980.95		3459.50	
Less Returns and Allowances.	17.00		14.50	
Net Sales.		4963.95		3445.00
Cost of Merchandise Sold:				
Gross Purchases.	6262.80		2235.30	
Less Returns and Allowances.	100.00		57.80	
Net Purchases.	6162.80		2177.50	
Add Inventory, March 1	7629.50		14878.55	
Add Freight In	733.92		257.87	
Total Cost of Merchandise for Sale	14526.22		17313.92	
Less Inventory, March 31	11735.06		15378.84	
Cost of Merchandise Sold		2791.16		1935.08
Gross Profit on Sales.		2172.79		1509.92
Total Gross Profit on Sales				3682.71
Operating Expense:				
Selling Expenses:				
Store Salaries		405.00		
Drivers Wages.		292.50		
Store Supplies Used.		126.40		
Delivery Supplies Used		65.80		
Catalogs and Price Lists Used.		35.00		
Expired Insurance on Merchandise		7.75		
Expired Insurance on Fixed Assets.		14.56		
Depreciation on Store Equipment.		2.75		
Depreciation on Delivery Equipment		34.58	984.34	
General Expenses:				
Rent Expense		350.00		
Office Salaries.		544.50		
Partners Salaries.		1000.00		
Office Supplies Used		64.50		
Postage Used		30.60		
Depreciation on Office Equipment		9.75		
Loss on Bad Debts.		42.20		
Miscellaneous General Expense.		16.10	2057.65	
Total Expenses				3041.99
Net Profit from Operations.				640.72
Other Income:				
Purchases Discount			188.89	
Interest Income.			24.11	
Total Other Income				213.00
Gross Income.				853.72
Deductions from Income:				
Sales Discount			72.97	
Interest Expense			30.83	
Total Deductions from Income				103.80
Net Profit.				749.92

Illustration 62, Profit and Loss Statement

March 31, 19-

42	Accrued Interest on Notes Receivable	522	
56	Interest Income		522
	To record accrued interest on notes receivable		
	31		
53	Loss on Bad Debts	4220	
6	Reserve for Bad Debts		4220
	To record the reserve for bad debts		
	31		
42	Store Supplies Used	2640	
44	Delivery Supplies Used	6580	
44	Catalogs & Price Lists Used	35-	
50	Office Supplies Used	6450	
51	Postage Used	3060	
9	Store Supplies		2640
10	Delivery Supplies		6580
11	Catalogs & Price Lists		35-
12	Office Supplies		6450
13	Postage		3060
	To record supplies and postage used		
	31		
43	Expired Insurance on Merchandise	2231	
44	Expired Insurance on Fixed Assets		
46	Prepaid Insurance		2231
	To record expired insurance		
	31		
55	Prepaid Interest on Notes Payable	15-	
58	Interest Expense		15-
	To record prepaid interest on notes payable		
	31		
45	Depreciation on Store Equipment	275	
46	Depreciation on Delivery Equipment	3458	
52	Depreciation on Office Equipment	975	
17	Depr. Res. for Store Equipment		275
19	Depr. Res. for Delivery Equipment		3458
21	Depr. Res. for Office Equipment		975
	To record estimated depreciation on fixed assets		

Illustration 63, Adjusting Entries

March 31, 1913

58	Interest Expense	25 83	
23	Accrued Interest on Notes Payable		25 83
	To record accrued interest on notes payable		
38	Store Salaries	45 —	
39	Driver's Wages	32 50	
48	Office Salaries	60 —	
25	Accrued Wages		137 50
	To record 3 days accrued salaries		

Illustration 63, Adjusting Entries—Concluded

When the debits and credits in the eight adjusting entries are posted, the account balances in the ledger will be the same as stated in the Profit and Loss and Balance Sheet columns of the Work Sheet. Some accountants use two additional columns on the Work Sheet under the title Adjusted Trial Balance and include in these columns the adjusted account balances in which case the balance of the accounts on the ledger after the adjustments are posted will agree with those on the Adjusted Trial Balance on the Work Sheet.

Closing Entries. The purpose of the closing entries is to credit each partner's Capital account with his share of the net profit. The closing entries are usually in two groups, (a) to summarize the trading accounts, and (b) to summarize the income and expense accounts. The trading accounts are usually summarized in an account with the title Trading and the balance of this account transferred to an account with the title Profit and Loss Summary or Profit and Loss. The balance of the income and expense accounts are summarized in the Profit and Loss account and the balance of the Profit and Loss account transferred to the Capital accounts as authorized by the articles of copartnership.

The entries in the general journal on pages 261 and 262 (Illustration 64) are those prepared by the accountant for Wolfe & Marx to close the ledger, March 31. The basis for these entries are the amounts entered in the Trading and Profit and Loss Statement columns on the Work Sheet and the account titles written on the same line with the amounts entered in these columns. As explained in a previous discussion, the accountant can safely use the figures on the Work Sheet as a basis for the closing entries because he has proved the facts on the Work Sheet before using them as a basis for the Balance Sheet and Profit and Loss Statement.

The number of entries required to close the ledger will depend entirely upon the number of temporary proprietorship accounts and the grouping of these accounts by the accountant in closing. You will observe that the accountant has used ten separate entries to close the ledger of Wolfe & Marx. The purpose of each entry stated in the order in which they appear is briefly described as follows:

Six entries are required to summarize the trading accounts in the two separate departments into the Trading account and to transfer the gross profit on sales in each department to the Profit and Loss account. The figures and account titles in these entries are those in the Trading columns of the Work Sheet and the account titles written on the same line with the amount. When these six entries are posted, all the trading accounts will be in balance, the March 31 inventory in each department will be recorded in the Inventory account for the department and the gross profit on sales in each department will be recorded on the credit side of the Profit and Loss account.

Four entries are used to close the income and expense accounts. The first entry is to summarize the operating expense accounts into the Profit and Loss account, the second, the non-operating income accounts, the third, the non-operating expense accounts, and the fourth to close the Profit and Loss account and transfer the net profit to the Capital accounts. When these four entries are posted, all temporary proprietorship accounts will be closed and each partner's share of the net profit will be recorded on the credit side of his Capital account. The Trading account and the Profit and Loss account resulting from posting the closing entries are shown on page 263.

You will observe that when posting, the accountant has not credited the Trading account with the total amount set opposite the title of the account in the journal entry but with the several amounts which appear in the debit or credit entry. This provides in the Trading and Profit and Loss accounts sufficient information for preparing the Profit and Loss Statement if desired. In fact many accountants close the ledger and prepare the Profit and Loss Statement from the Trading and Profit and Loss accounts. The owners of the business are not interested in the order of completing the work at the close of the fiscal period but they are interested in having accounts in the ledger which show all the facts reported to them on the Profit and Loss Statement.

Post-closing Trial Balance. The purpose of a Trial Balance is to prove the equality of debits and credits in the ledger. A Trial Balance prepared from the ledger after the adjusting and closing entries are posted is referred to as a Post-closing Trial Balance. The Trial Balance in the illustration on page 264 was prepared from the ledger of Wolfe & Marx by the accountant after the adjusting and closing entries were posted.

The Post-closing Trial Balance provides information for the Balance Sheet and many accountants prepare the Balance Sheet from this Trial Balance.
(Concluded on page 264)

March 31, 19-

52	Trading	14643 22	
53	Dept. A Purchases		7120 50
52	Dept. A Freight		6212 80
53	Dept. A Freight Return		733 72
54	Dept. A Sales Return		17 -
	To summarize Dept. A trading accounts with a debit balance		
	31		
52	Dept. A Inventory	11735 06	
52	Dept. A Sales	4980 95	
54	Dept. A Purchases Return	100 -	
	Trading		16816 01
	To summarize Dept. A trading accounts with a credit balance		
	31		
52	Trading	2172 79	
60	Profit and Loss		2172 79
	To transfer Dept. A gross profit on sales to the Profit and Loss account		
	31		
52	Trading	17386 22	
53	Dept. B Inventory		14878 55
53	Dept. B Purchases		22353 00
52	Dept. B Freight		257 77
53	Dept. B Sales Return		1450
	To summarize Dept. B trading accounts with a debit balance		
	31		
52	Dept. B Inventory	15378 84	
52	Dept. B Sales	3459 50	
57	Dept. B Purchases Return	57 50	
52	Trading		18896 14
	To summarize Dept. B trading accounts with a credit balance		
	31		
52	Trading	1509 92	
60	Profit and Loss		1509 92
	To transfer Dept. B gross profit on sales to the Profit and Loss account		

Illustration 64, Closing Entries

March 31, 19-

60	Profit and Loss	364.99		
38	Store Salaries		40.50	—
39	Store Wages		292.50	
40	Store Supplies Used		126.40	
41	Delivery Supplies Used		63.80	
42	Catalogs & Price Lists Used		35.00	
43	Expired Insurance on Freight		7.75	
44	Expired Insurance on Fixed Assets		142.56	
45	Depreciation on Store Equipment		27.50	
46	Depreciation on Delivery Equipment		34.58	
47	Rent Expense		350.00	
48	Office Salaries		544.50	
49	Partner Salaries		1000.00	
50	Office Supplies Used		64.50	
51	Partner's Draw		306.00	
52	Depreciation on Office Equipment		97.50	
53	Loss on Fixed Assets		42.20	
54	Miscellaneous General Expense		161.00	
	To close the expense accounts			
	31			
55	Purchases Discount	188.89		
56	Interest Income	24.11		
60	Profit and Loss		213.00	—
	To close the Purchases Discount and Interest Income accounts			
	31			
60	Profit and Loss	103.80		
57	Sales Discount		72.87	
58	Interest Expense		30.85	
	To close the Sales Discount and Interest Expense accounts			
	31			
60	Profit and Loss	749.92		
26	W. H. H. Capital		374.96	
27	J. H. H. Capital		374.96	
	To close the Profit and Loss account			

Illustration 64, Closing Entries—Concluded

Trading

Mar. 31	Dept. A Inv.	3/1	\$5	762950	Mar. 31	Dept. B Inv.	3/1	\$5	1173506
31	Dept. A Purchases		\$5	626280	31	Dept. B Sales		\$5	498095
31	Dept. A Ret. Drawings		\$5	73392	31	Dept. B Ret. Drawings		\$5	100—
31	Dept. A Sales			15—					
31	Dept. A Ret. Drawings		\$5	217279					
				681601					1681601
Mar. 31	Dept. B Inv.	3/1	\$5	187855	Mar. 31	Dept. B Inv.	3/1	\$5	1537884
31	Dept. B Purchases		\$5	223530	31	Dept. B Sales		\$5	345950
31	Dept. B Ret. Drawings		\$5	25787	31	Dept. B Ret. Drawings		\$5	5780
31	Dept. B Sales			1450					
31	Dept. B Ret. Drawings		\$5	150992					
				189514					189514

Profit & Loss

Mar. 31	Store Salaries	\$5	405—	Mar. 31	Profit on Sales Dept. A	\$5	217279
31	Drivers Wages	\$6	29250	31	Profit on Sales Dept. B	\$5	150992
31	Store Supplies Used	\$6	12640	31	Purchases Discount	\$6	18889
31	Delivery Exp. Used	\$6	6580	31	Interest Income	\$5	2411
31	Carriage Exp. Used	\$5	35—				
31	Exp. Ins. on Mchse.	\$5	775				
31	Exp. Ins. on Fr. Assets	\$6	1456				
31	Exp. on Store Equip.	\$5	275				
31	Dep. on Del. Equip.	\$5	3455				
31	Rent Expense	\$5	350—				
31	Office Salaries	\$5	54450				
31	Partners Salaries	\$6	1000—				
31	Office Supplies Used	\$6	6450				
31	Postage Used	\$5	3060				
31	Dep. on Off. Equip.	\$6	975				
31	Loss on Bad Debts	\$6	4220				
31	Misc. Gen. Exp.	\$6	1610				
31	Sales Discount	\$6	7297				
31	Interest Expense	\$6	3083				
31	N. Y. Hoq. Cap.	\$6	37496				
31	N. Y. Marx Cap.	\$6	37496				
			389571				389571

Illustration 65, Trading and Profit and Loss Accounts

ance. As explained on page 260, the owners of a business are not interested in the order of procedure in completing the work at the close of the fiscal period, but they are interested in having account balances in the ledger which show the same facts as are reported to them, also in knowing that the ledger is in balance at the beginning of the next fiscal period.

Wolfe & Marx
Post-closing Trial Balance, March 31, 19-

Cash	100.00	
Petty Cash	2.00	
Notes Receivable	100.00	
Accrued Interest on Notes Rec.	5.22	
Accounts Receivable	527.15	
Prepaid Insurance		42.25
Light, Heat, Water	175.50	
Supplies Inventory	53.14	
Store Supplies	4.00	
Delivery Supplies	3.25	
Carriage & Haulage	2.00	
Office Supplies	1.25	
Postage	1.00	
Prepaid Insurance	2.75	
Accrued Interest on Notes Payable	.15	
Store Equipment	55.00	
Depreciation Reserve for Store Equip.		4.25
Delivery Equipment	10.00	
Depreciation Reserve for Delivery Equip.		46.25
Office Equipment	75.00	
Depreciation Reserve for Office Equip.		145.25
Notes Payable		700.00
Accrued Interest on Notes Payable		25.33
Accounts Payable		447.45
Wolfe, Capital		137.50
Marx, Capital		141.14
	4055.14	4055.14

Illustration 66, Post-closing Trial Balance

REPORTS

Complete Reports Nos. 63 and 64 in the work book and present to the instructor for approval. Continue with the text discussion until Report No. 65 is required on page 274.

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CORPORATIONS

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CHAPTER XXI

THE CORPORATE ORGANIZATION

Assets are needed in the operations of a business. The title to these assets may be vested in (a) one individual, (b) two or more individuals under a partnership agreement, or (c) in three or more individuals under a corporate organization. The sole proprietorship and partnership organizations are discussed in preceding chapters. The discussion in this and the four chapters which follow relate to the corporate organization.

Corporations. The Supreme Court of the United States has defined a corporation as "an association of individuals united for some common purpose and permitted by the law to use a common name, and to change its members without dissolution of the association." This means that the corporation is an artificial person created by law for the purpose of operating a business. When brought into existence by law, the corporation has the privileges which the law gives it, usually the same as for any citizen governed by the same law and engaged in a business of like nature.

The Purpose of a Corporation. A corporation is organized to operate a specific business in the same manner as a similar business would be operated by a sole proprietor or a partnership. The required assets in both the partnership and corporation are secured through the combined investments of more than one investor; at least three investors are required in the formation of a corporation.

The corporate form of organization has the legal advantage of the partnership in that it (a) limits the liabilities of each investor, (b) permits many investors, and (c) allows each investor to transfer his proprietary interest in the corporation without affecting its operations.

Organization of a Corporation. Corporations are organized under state and national laws. The law which grants the right to incorporate a business also provides for the method of incorporation. Those who wish to combine their assets and operate a business as a corporation must comply with the law in order to form the corporation. When the investors have complied with the law and their request has been granted, they are authorized to operate the business as a corporation. This legal right is granted through a certificate of incorporation usually known as a *charter*.

The following quotation from the Statute of New York sets forth the procedure required in that state to secure a charter:

"Except as provided in section 2a of this chapter, three or more persons may become a stock corporation for any lawful business purpose or purposes,

by making, signing, acknowledging, and filing a certificate which will contain:

- (1) The name of the proposed corporation.
- (2) The purpose or purposes for which it is to be formed.
- (3) The amount of capital stock, and if any portion be preferred stock the preferences thereof.
- (4) The number of shares of which the capital stock shall consist, the value of which shall not be less than five nor more than one hundred dollars and the amount of capital not less than five hundred dollars, with which the said corporation will begin business. (By amendment of the original law, stock may now be issued which has no par value.)
- (5) The city, village, or town in which its principal business office is to be located. If it is to be located in the city of New York, the borough there in which it is to be located.
- (6) Its contemplated duration. This may be made perpetual.
- (7) The number of its directors, not less than three.
- (8) The names and post office addresses of the directors for the first year.
- (9) The names and post office addresses of the subscribers to the certificate of incorporation and the number of shares in the corporation subscribed by each.
- (10) Signature of the three or more subscribers.

Charter. The certificate signed by the incorporators containing the requirements specified by law is referred to as a *charter* after it has been approved by the proper state officials. In other words, the charter is the written authority granted the investors to operate the business as a corporation. Illustration 67 on page 269 shows a charter granted under the New York law.

When this application for a charter has been approved by the proper state officials, it becomes the charter which authorizes the corporation. When received from the state officials, the charter is registered in the county in which the main office is to be located and retained by the corporation.

Operations of a Corporation. The business of a corporation is operated by its officers. These officers are elected by the board of directors who in turn are elected by the stockholders. Thus, the individual stockholder has a voice in the operation of the corporation through his vote for board of directors but this does not authorize him to bind the corporation by contracts.

At the time the corporation is organized, the proprietorship is divided into shares of equal value, the investment of each stockholder consisting of one or more shares. Each stockholder has a vote for each share of stock which he holds and the majority of the shares control the operations of the corporation. Thus, if one individual owns 51% of the shares of stock issued and outstanding it is possible for him to control the election of the board of directors and officers. It is quite evident, however, that any rivalry on the part of the stockholders for control of the corporation would not work to the advantage of the corporation;

CERTIFICATE OF INCORPORATION
OF
THE WAYMAN MERCANTILE CO., Inc.

We, the undersigned, all being persons of full age, and at least two-thirds being citizens of the United States and one of us a resident of the state of New York, desiring to form a stock business corporation pursuant to the provisions of the Business Corporation Law, The General Corporation Law and the Stock Corporation Law of the State of New York, do make, sign, acknowledge, and file a certificate for that purpose, as follows:

First: The name of the proposed corporation is

THE WAYMAN MERCANTILE CO., Inc.

Second: The purpose for which it is formed is:

To engage in the business of buying and selling merchandise of all kinds in one or more places of business and to contract for, buy, sell, hold, lease, mortgage, grant and otherwise acquire, and dispose of all real and personal property as shall from time to time be found necessary and convenient for the purpose of the corporation's business.

Third: The amount of the capital stock is fifty thousand dollars (\$50,000.00).

Fourth: The number of shares of which the capital stock consists is five hundred with the par value of \$100.00 each and the amount of the capital with which the corporation will begin business is \$25,000.00.

Fifth: Its principal office is to be located in the city of Olean, Cattaraugus County, New York.

Sixth: Its duration is to be for a term of twenty years.

Seventh: The number of its directors is to be three.

Eighth: The names and post office addresses of the directors for the first year are as follows:

B. A. Wayman.....516 Main St., Olean, N. Y.
C. W. Milton.....1565 Chestnut St., Bradford, Pa.
G. H. Waterson.....762 Mound St., Salamanca, N. Y.

Ninth: The names and post office address of the subscribers to the certificate and a statement of the number of shares of stock which each agrees to take in the corporation are as follows:

B. A. Wayman.....516 Main St., Olean, N. Y.....130 shares
C. W. Milton.....1565 Chestnut St., Bradford, Pa..... 50 "
G. H. Waterson.....762 Mound St., Salamanca, N. Y..... 50 "
B. A. Gregg.....417 Mill St., Olean, N. Y..... 10 "
G. J. Wayman.....1216 Allen St., Olean, N. Y. 10 "

In Witness Whereof, we have made, signed, acknowledged and filed this certificate in duplicate.

Dated September 1, 1929.

B. A. Wayman
C. W. Milton
G. H. Waterson

State of New York }
County of Cattaraugus } ss.

Personally appeared before me, R. L. Watson, a notary public in and for Cattaraugus County, New York, B. A. Wayman, C. W. Milton, and G. H. Waterson, to me known and known to me to be the same persons described in and who executed the above instrument and they duly acknowledged to me that they executed the same.

R. L. Watson
Notary Public, Cattaraugus County, N. Y.

(NOTARIAL SEAL)

each stockholder should be in accord with the general policies of those responsible for the affairs of the corporation if the business is to be a success.

The usual legal requirement is for an election of board of directors and officers at least once each year. While the same board and the same officers may be continued for many years, yet it is better policy to have an annual meeting of the stockholders and give each an opportunity to express his opinion through his vote on the operations of the corporation for the past year.

By-laws. The law under which a corporation is organized usually provides detailed information relative to the organization of the corporation and such regulations as are necessary in order to protect the interest of the investors. No attempt is made by the law to regulate the operations of the corporation in so far as they relate to the transactions completed by it with its stockholders or those with whom it deals.

The stockholders are authorized to make such rules and regulations as they may deem advisable and to operate the corporation according to these rules. These rules and regulations prepared by the officers and adopted by the stockholders are referred to as *by-laws*. Any rules and regulations which are not contrary to the state law may be adopted for controlling the operations of the corporation. Usually the by-laws are adopted at the first meeting of the stockholders; if any changes are desired, amendments to the by-laws are made at subsequent meetings.

Proprietorship in the Corporation. Proprietorship is the owner's equity in the assets (assets minus liabilities) used in the operations of a business. The corporation is an artificial person created by law with the same privileges possessed by a natural person subject to the same law. The corporation therefore has an equity or proprietorship in the assets invested by its stockholders.

The authorized capital of a corporation is the amount of money stated in the charter that will be needed to operate the business. This capital is secured by subscriptions from those who wish to invest in the corporation. The capital is divided into shares; in New York the value of these shares may be any amount from \$5.00 to \$100.00. The charter illustrated provides for shares of \$100.00 each.

The proprietorship available at the time of organization is usually the cash collected from the subscribers and the written promises of the subscribers to pay for stock in the future. At any subsequent time the proprietorship may be more or less than at the beginning. If the business is operated at a profit, the corporate equity in the assets will be greater than at the beginning; if operated at a loss, the equity will be less.

Stock Certificate. The assets available at the time the charter is requested are the property of the investors. After the charter is granted, these assets are transferred to the corporation and a certificate of stock is issued to each investor, showing the number of shares for which he has subscribed and paid;

the property available at the time the corporation is organized is the cash paid in or the subscriptions.

The one who has subscribed for stock is known as a *subscriber* and when he has paid for his stock and received his stock certificate, as a *stockholder*. The certificate issued to each stockholder should not only show the number of shares of stock which he owns and the par value of these shares but also the capital stock of the corporation and the number of shares it is authorized to issue; the only exception is no par value stock as explained in a subsequent paragraph.

One of the advantages of the corporation is that each stockholder may dispose of his stock without the consent of the other stockholders; in a partnership each partner is bound by the contract, hence can not dispose of his interest without the written consent of the other partner or partners. Space is provided on the back of each certificate of stock for transfer of title of the stock when sold. This is necessary because when a stockholder sells all of his stock in a corporation, he ceases to be a member of the corporation and the one to whom he sells his stock becomes a member in his place.

The proper official of the corporation should be notified of the sale of stock and the consequent change in ownership so that the new owner may be registered as a stockholder and receive his share of profit. The stockholder selling his certificate makes the transfer on the back of the certificate; usually the purchaser of stock presents the certificate purchased to the proper official of the corporation and receives a new certificate in his name.

The certificate of stock and authority for transferring ownership are explained and illustrated further in connection with the stock certificate book, page 289.

Classification of Stock. Article 3 on page 269 states: "The amount of capital stock, and if any portion be preferred stock the preferences thereof." These instructions indicate that more than one class of stock may be issued and that those who apply for a charter in New York must give specific information regarding preferred stock. There are usually two classes of stock issued, one common and the other preferred.

The distinction between these two classes of stock is usually the method of sharing the profits during the operation of the corporation and the division of the assets at the time of its dissolution. The distribution of the profit is referred to as *dividends* and is authorized by the board of directors.

Common Stock. When no preference is given any stockholder, all the stock is said to be *common stock*. Each stockholder will receive the same amount of dividend per share of stock he owns when the dividend is declared and will participate in the division of the assets according to the stock owned at the time the corporation is dissolved. Thus, if the board of directors declare a dividend of 6%, the owner of a certificate of common stock, par value \$100.00, will receive \$6.00 for each share stated in his certificate.

Preferred Stock. When some stock is to receive a preference, the stock is known as *preferred stock*. The usual distinction between preferred stock and common stock is that each certificate of preferred stock states the amount of annual dividend the stockholder may receive, while no mention is made of dividends on the certificate of common stock. Thus, the statement "8% dividend" on a certificate of stock indicates that the owner will receive 8% of the par value of his stock each year, provided the earnings are sufficient to pay this and the board of directors declare the dividend. The dividend stated on a certificate of preferred stock may be qualified through the use of such terms as participating, non-participating, cumulative and non-cumulative.

The term *participating* on a certificate of preferred stock in connection with the stated dividends indicates that the holder may receive more than this amount as dividend. This additional dividend will be available to the preferred stockholders only when the profit distributed by the board of directors is sufficient to pay both the common and preferred stockholders a rate greater than that stated on the preferred stock certificate. Thus, if the preferred dividends are 8% and a dividend of 10% is declared available to all stockholders, the holders of participating preferred stock will receive 2% more than the amount stated on each preferred certificate.

The term *non-participating* printed on a certificate of stock in connection with the stated dividend indicates that the preferred stockholder will not participate in the profits beyond the stated rate of dividend. This means that the common stockholders will receive a greater dividend than the preferred stockholders if the Board of Directors declare dividends in excess of the rate allowed on the preferred stock.

The term *cumulative* in connection with the stated dividend on a certificate of stock indicates that the stockholder is entitled to this amount of dividend for each year. When the profits earned in one year are not sufficient to pay the stated dividends to holders of cumulative preferred stock, the deferred dividend must be paid out of the earnings of subsequent years before the common stockholders receive a dividend.

The term *non-cumulative* in connection with the stated dividend indicates that the stockholder will not receive this dividend unless it is earned and declared within the year.

There may be other qualifying terms used in connection with common and preferred stock. The nature of the preference or the qualification of the stock is printed on the certificate of stock and must be consistent with the laws under which the corporation is organized and the by-laws of the corporation.

No Par Value Stock. When the charter states the authorized capital stock as a maximum number of shares but does not state the value of the combined assets to be invested, the stock issued to each stockholder has no par value and is known as *no par value stock*. The incorporators will place a value on the stock at the time the corporation is organized and each stockholder must invest this amount for each share subscribed.

A no par value certificate of stock issued to a stockholder states the investment in number of shares without reference to the value of each share. This is true even though the state law places a minimum value on each share of no par value stock. The no par value certificate of stock also states the number of shares the corporation is authorized by its charter to issue; this permits a stockholder to determine his interest in the corporate proprietorship shown on the Balance Sheet. The charter on page 269 authorizes par value stock because the par value of the investment and each share is stated in it. Had this charter stated "5,000 shares of no par value stock" the corporation would have had the authority to issue 5,000 shares and receive for each share any value that it might place upon it in excess of the minimum fixed by the state. Thus, if the charter authorizes 5,000 shares of stock and this is sold for cash at \$10.00 per share, the amount of the invested capital is \$50,000.00.

Proprietary Interest of Each Stockholder. Each stockholder is part owner of the corporate assets. The certificate of stock which he receives from the corporation states the number of shares and par value of his investment in dollars and cents or states the number of shares only; par value stock states the number of shares and par value in dollars and cents, and no par value stock states the number of shares. The interest of the stockholder in the corporate proprietorship can be determined only from the facts stated in the certificate and a Balance Sheet which shows (a) the corporate proprietorship and (b) the number of shares that have been issued and are outstanding.

Values of Stock. A share of stock in a corporation may have three values as follows:

(1) Par value, that is, the amount stated in the certificate; this applies only to par value stock.

(2) Book value, that is, the interest in the corporate proprietorship according to the proprietorship accounts in the ledger. This may be more or less than the par value; it applies both to par value stock and stock issued without a par value.

(3) Market value, that is, the price at which the stock may be sold, or the price quoted on a stock exchange. This value may be more or less than the par value or book value; it applies to both par value and no par value stock. Frequently the earnings of a corporation permit unusually large dividends, hence the market price may be far in excess of the book value.

Liquidation Value. When a corporation discontinues business and cash is received for all the assets, each stockholder will have an interest in the cash remaining after the liabilities have been paid. This interest is referred to as the *liquidation value* of the stock. The liquidation value of a certificate will depend upon the class of stock and its participation in the assets of the corporation as stated on the certificate of stock.

Method of Showing Proprietorship on the Balance Sheet. Each stockholder receives a copy of the Balance Sheet. The information contained in the Balance Sheet should be such that he can ascertain his interest in the proprietorship of the corporation. The Balance Sheet in the illustration at the right shows the proprietorship in a corporation which is authorized to issue

THE MASON MFG. CO.
BALANCE SHEET, December 31, 19....

TOTAL ASSETS.....		93,500—
TOTAL LIABILITIES.....		22,700—
PROPRIETORSHIP:		
Authorized Capital Stock.....	75,000—	
Less Unissued Capital Stock.....	25,000—	
Capital Stock Outstanding.....	50,000—	
Surplus.....	20,800—	
PROPRIETORSHIP.....		70,800—

stock with a par value and the one in the illustration at the left below, the proprietorship of a corporation authorized to issue no par value stock. In each Balance Sheet, the assets and liabilities are shown each in one amount because the purpose of the illustrations is simply to show the method of reporting proprietorship.

THE MASON MFG. CO.
BALANCE SHEET, December 31, 19....

TOTAL ASSETS.....		93,500—
TOTAL LIABILITIES.....		22,700—
PROPRIETORSHIP:		
Capital Stock—No Par Value:		
Authorized.....750 shares		
Unissued.....250 shares		
Outstanding.....500 shares	50,000—	
Surplus.....	20,800—	
PROPRIETORSHIP.....		70,800—

Unissued stock refers to the number of shares which the corporation has not yet issued. This has no asset value, hence is shown as a deduction from the number of shares the corporation is authorized to issue, in order that each stockholder may know the number of

shares issued and outstanding. Surplus refers to accumulated profit available for dividends.

From either Balance Sheet, the book value of each share of stock may be determined as 1 500 of \$70,800.00 or \$141.60. The stockholder who owns a certificate of stock for 10 shares will have a proprietary interest of \$1,416.00.

REPORTS

Complete Reports Nos. 65 and 66 in the work book and present to the instructor for approval. Continue with text discussion until Report No. 67 is required on page 280.

CHAPTER XXII

OPENING AND CLOSING ENTRIES FOR A CORPORATION

The charter states the authorized capital stock of the corporation. The discussion in this chapter relates to the method of recording (a) the authorized capital stock, (b) the assets received as a result of the investment, and (c) the increase or decrease in capital due to profits or losses.

Opening Entry for Par Value Stock. Until the charter is granted, any assets provided by the investors is the property of each investor. When the charter is granted, the directors mentioned therein will elect officers to accept the property invested or collect the promised investments and control the use of this property in the operations of the corporation. Opening entries refer to those made at the time the corporation is organized. When the stock has par value, it is customary to first record the par value of the authorized capital stock and then record the assets received by the officers from the subscribers. The corporation may be organized to operate a new business or to continue the operations of a business which has been operated as a sole proprietorship or partnership. It is customary under either of these conditions to record the authorized capital stock. When all of the capital stock is paid in cash at the time the corporation is organized, it is not essential that the authorized capital stock be recorded but it is better to do so.

Recording the Authorized Capital. The third paragraph of the charter on page 269 states: "The amount of the capital stock is \$50,000.00", and the fourth paragraph, "The number of shares of which the capital stock consists is 500 with a par value of \$100.00 each." The fact that the corporation is authorized through its officers to issue this amount of stock does not provide assets but it does provide a means for securing these assets. For this reason, the right to issue capital stock and thereby secure assets applied to the charter illustrated may be stated in equation form as:

$$\text{UNISSUED CAPITAL STOCK } \$50,000.00 = \text{CAPITAL STOCK } \$50,000.00$$

The entry in the illustration at the right shows the method of recording in journal form the facts stated in the above equation. The debit to the Unissued Capital Stock account records the amount of the assets that may be received for stock issued when sold at par. The credit to the Capital Stock account records the par value of stock authorized by the charter. The Unissued

September 1, 19				
	Unissued Capital Stock	50000	—	
	Capital Stock			50000
	To record the authorized capital.			

Capital Stock account is a valuation account, proprietorship in nature, indicating a subtraction from the balance of the Capital Stock account and shown thus on the Balance Sheet.

Recording Stock Issued for Assets Invested. All states require that assets be available before the charter is issued. These assets may be available in the form of cash or other property or in the form of subscriptions by responsible subscribers. The usual plan is to accept subscriptions and collect from each subscriber a part of the subscription so that this may be available in cash at the time application is made for the charter. When the charter is granted, the balance due from each subscriber is collected and a certificate of stock issued to the subscriber for the par value of his investment. The list of those who have subscribed for stock in a corporation to be organized is referred to as the *subscribers* and the list as the *subscription list*.

Referring to the charter on page 269, you will observe that there are five subscribers and that each has subscribed for the number of shares stated. It may be assumed that a part of the cash was collected from each subscriber at the time he subscribed and the remainder is to be collected when the charter is received. In paragraph four of the charter it states that the beginning capital is \$25,000.00 and this amount has been subscribed. Assuming that the \$25,000.00 is all collected in cash from the subscribers at the time the charter is received, the entry in the cash book is as follows:

CASH				Receipts
19 Sept.	1	Unissued Cap. Stock	Received from Subscribers	25000—

The Cash account is debited to record the increase in the asset cash. The Unissued Capital Stock account is credited to record the decrease in the amount of the stock which the corporation is still authorized to issue. Certificates of stock are issued to each of the five subscribers for the par value of the stock subscribed; these subscribers now become stockholders. The certificate issued each stockholder states the number of shares for which he has paid, the number of shares the corporation is authorized to issue, the par value of each share and the authorized capital of the corporation.

Subscriptions on the Deferred Payment Plan. When the full amount a subscriber is to invest is not collected from him at the time of his subscription or at the time the charter is granted and the balance is to be collected in one or more installments, the stock is said to be sold on the *installment* or *deferred payment* plan. A receipt is issued to each subscriber for the amount of cash collected from him at the time he subscribes or at subsequent times. A certificate of stock will not be issued to him by the corporation until it has collected from him the full amount of his subscription.

A sale of stock to a subscriber on the deferred payment plan requires an account with him. He is debited in this account for the amount of his sub-

scription, which is usually the par value of the stock subscribed, and credited for the cash received from him at the time of the subscription and for subsequent collections. The accounts with the subscribers are usually kept in a separate ledger known as the *subscribers ledger*.

The subscriber to whom stock is sold on the deferred payment plan is a debtor of the corporation which is authorized by the charter to collect from him. This right to collect from a delinquent subscriber indicates that the balance due from a subscriber is an asset of the corporation; this asset is usually referred to as *subscriptions receivable* to distinguish it from accounts receivable.

Illustration. January 2. The Dunn Laundry Co. was incorporated with an authorized capital of \$60,000.00, 600 shares of common stock, par value, \$100.00.

The entry to record the par value of the authorized capital stock is in the illustration at the right. This entry is the same as that given on page 275. The accounts are debited and credited for the same reason as in the preceding illustration.

January 2, 19			
Unissued Capital Stock	60000	—	
Capital Stock			60000
To record the authorized capital.			

At the time the promoters of the corporation decided to seek assets through subscriptions, it was decided to permit these subscriptions to be paid one-half cash at the time the subscription was made and the balance in sixty days. Five hundred shares were subscribed on these terms at the time the charter was requested and granted.

From the point of view of the corporation, the subscription of each subscriber is an asset of the corporation usually referred to as subscriptions receivable. This asset is recorded as a debit to an account with the title Sub-

scriptions Receivable.

The entry in the illustration at the left shows the method of recording this asset. The debit to the Subscriptions Receivable account records the increase in this asset and the credit to the

January 2, 19			
Subscriptions Receivable	50000	—	
Capital Stock Subscribed			50000
To record the following subscriptions ½ cash, ½ 60 days:			
B. B. Lund . . . \$20000.00			
A. H. Lund . . . 10000.00			
G. C. Steele . . . 10000.00			
O. W. Dow . . . 10000.00			

Capital Stock Subscribed account records the increase in proprietorship; this increase is not recorded in the Capital Stock account because this account is already credited with the authorized capital stock. The terms of the subscription and the names of the subscribers are given in the explanation of the entry.

When the 50% cash is collected from the subscribers at the time the subscription is made, it is placed in the custody of one of the incorporators until the charter is granted at which time it will be given to the officers of the corporation for deposit in the bank to the credit of the corporation. The entry in the corporation's cash book to record this cash is as follows:

CASH				Receipts	
19 Jan.	2	Subscriptions Rec.	50 % of Subscription as follows: B. B. Lund, \$10,000.00 A. H. Lund, \$5,000.00 G. C. Steele, \$5,000.00 O. W. Dow, \$5,000.00	25000	—

March 1. The officers of the corporation collected from the subscribers the other 50% of the stock subscribed. The entry to record this collection on the receipts side of the cash book is:

CASH				Receipts	
19 Mar.	1	Subscriptions Rec.	50% of Subscription (Names of subscribers as above.)	25000	—

Each subscriber is now entitled to receive stock and become a stockholder because he has paid his subscription in full. When the stock is issued, the par value is recorded in the general journal as a debit to the Capital Stock Subscribed account and as a credit to the Unissued Capital Stock account as in the illustration at the right. The debit re-

March 1, 19					
		Capital Stock Subscribed.....	50000		
		Unissued Capital Stock.....		50000	—
		To record the stock issued to subscribers on the deferred payment plan.			

a subtraction from the Capital Stock Subscribed account and the credit, a subtraction from the Unissued Capital Stock. When this entry is posted, the Capital Stock Subscribed account is in balance and the Unissued Capital Stock account shows a debit balance of \$10,000.00, the par value of the stock the corporation is yet authorized to issue.

Entry for Common and Preferred Stock. When the incorporators elect to issue both common and preferred stock, the par value of each class of stock is stated in the charter and will be recorded separately in the opening entry. The separate account titles required in the opening entry are *Unissued Capital Stock Common*, *Unissued Capital Stock Preferred*, *Capital Stock Common* and *Capital Stock Preferred*.

Illustration. July 1. The New Publishing Co. received its charter of incorporation with authority to issue 2000 shares of common stock, par value \$100.00, and 1000 shares of 6% cumulative preferred stock, par value \$100.00.

The entry in the illustration at the right is to record the authorized capital stock. The debits and credits are for the same reason as in the preceding entries made for the same purpose. Each type of stock is recorded in a separate account because the two types of stock have no relation to each other.

July 1, 19			
Unissued Capital Stock, Com.	200000	—	
Unissued Capital Stock, Pref.	100000	—	
Capital Stock, Common			200000
Capital Stock, Preferred			100000
To record the authorized capital stock.			

When the authorized capital stock has been recorded, the assets invested will be recorded. The method of recording will depend entirely upon the contract in the subscription. If each subscriber has agreed to pay cash upon demand, the cash collected will be recorded as a debit to the Cash account and a credit to the Unissued Capital Stock, Common or Unissued Capital Stock, Preferred accounts depending upon the kind of stock subscribed. On the other hand, if the subscriptions are on the deferred payment plan, the Subscriptions Receivable account is debited for the par value of both types of stock subscribed and the Capital Stock Subscribed accounts credited for the par value of each type of stock. The Subscriptions Receivable account is credited for the amount of cash collected from the subscriber at the time the corporation is organized or when each installment is paid.

Assets Other Than Cash Received as an Investment. The usual investment in a corporation organized to operate a new business is cash but the corporation may agree to accept assets other than cash. The entry in the illustration at the right shows the method of recording the transaction with a subscriber in which the Union Mfg. Co., a corporation, accepts land, value \$100,000.00, for a subscription of equal amount. The Land account is debited to record the increase in the asset land. The Unissued Capital Stock account is credited for the par value of the stock for which the land is received and a certificate of stock is issued to the subscriber for the number of shares issued to him.

July 1, 19			
Land	100000	—	
Unissued Capital Stock			100000
Accepted land in payment for stock subscribed.			

Opening Entry for No Par Value Stock. When a corporation is authorized to issue no par value stock, the law under which it is organized usually places a minimum value on this stock. The incorporators may fix the price at any amount in excess of this minimum. A subscriber for no par value stock will be required to invest assets equal to the value placed on it by the incorporators.

Since only the value of the stock subscribed is known at the time of organization, it is not customary to record the authorized capital stock through

an entry debiting Unissued Capital Stock and crediting Capital Stock. Information about the number of shares that may be issued and the number of shares actually issued may be given in connection with the Capital Stock account. The usual plan is to state the total number of shares authorized in connection with the title of the account and the number of shares issued in the explanation column on a line with the amount received for these shares.

When no par value stock is sold on the deferred payment plan, the entries to record the receipt of subscriptions, the receipt of cash from the subscribers, and the issue of stock to subscribers are the same as for par value stock. The debit to the Subscriptions Receivable account will be the total number of shares subscribed at the selling price of the no par value stock.

Illustration. The Acme Laundry Company secures a charter authorizing it to issue 1,000 shares of no par value stock. July 1, 800 shares were subscribed for at \$50.00 a share and cash received from each subscriber in full.

Since cash was received, it is not necessary to make an entry debiting Subscriptions Receivable and crediting Capital Stock Subscribed for \$40,000.00. This entry is omitted and the Capital Stock account credited for \$40,000.00. The entry to record the transaction on the receipts side of the cash book is:

PAGE 26			CASH		Receipts	
19	July	1 79	Capital Stock (Auth. 1,000 Shares.)	800 Shares	40000	—

When this entry is posted, the Capital Stock account will appear as in the illustration at the right.

You will observe that the Capital Stock account contains full information regarding the number of shares authorized and the number of shares issued.

CAPITAL STOCK			PAGE 79	
			Authorized 1000 Shares	
19	July	1	800 shares	40000

The second Balance Sheet on page 274 illustrates the method of showing full information regarding no par value stock on the Balance Sheet. The total number of shares authorized as shown in connection with the title of the account less the total number of shares issued recorded in the explanation column of the Capital Stock account is the total number of shares yet to be issued. With this information and the present proprietorship, the stockholder may ascertain the book value of his certificate.

REPORT

Complete Report No. 67 in the work book and present to the instructor for approval. Continue with the text discussion until Report No. 68 is required on page 286.

Incorporating a Going Business. When a going business is incorporated, it is customary for the corporation not only to take over the assets but also to assume the liabilities and issue stock to the individual owner or partners for the proprietorship of the going business. The par value of the stock issued to the owner or owners of the going business is usually the balance of the proprietorship account or accounts unless the corporation is to pay more than the book value as explained in a subsequent paragraph.

The entry to record the authorized capital stock, when stock with a par value is to be issued, is the same whether the corporation is organized as a new business or to continue the operation of a going business. When no par value stock is to be issued, the credit to the Capital Stock account is for the selling price of the stock at the time it is issued.

The Balance Sheet of a going business is used as a basis for recording the assets, liabilities, and proprietorship when incorporating. An appropriate account is debited with the value of each asset received from the going business and an account with the owner as vendor is credited for the total value of the assets. The account with the vendor is debited for the total liabilities and the appropriate account credited for the amount of each liability. The account with the vendors is debited for the par value of the stock issued to them and the Unissued Capital Stock account is credited.

Illustration. September 1. Wilson & Jones, equal partners in a partnership operating a canning business, secured a charter to continue the operations of the business under the corporate name of The Peerless Canning Company. The corporation is authorized to issue 7,500 shares of stock, par value \$10.00 per share. Each partner accepts 1,250 shares of stock for his proprietorship in the partnership.

The Balance Sheet below shows the assets, liabilities and proprietary interest of the partners, August 31, the day before the transfer is made.

WILSON AND JONES CANNING CO.

BALANCE SHEET, August 31, 19

Assets:		Liabilities:	
Cash.....	2478 20	Notes Payable.....	2500 —
Notes Receivable.....	600 —	Accounts Payable.....	3521 60
Accounts Receivable.....	4219 27	Total Liabilities.....	6021 60
Factory Equipment 24,769.05		Proprietorship:	
Less Dep. Res. ... 2,852.40	21916 65	J. C. Wilson, Capital.....	12500 —
Factory Supplies.....	321 80	J. W. Jones, Capital.....	12500 —
Prepaid Insurance.....	129 50		
Office Equipment... 1,500.00			
Less Dep. Res. ... 250.00	1250 —		
Office Supplies.....	106 18		
TOTAL ASSETS.....	31021 60	TOTAL LIAB. AND CAPITAL.....	31021 60

The cash balance shown on the Balance Sheet will be transferred to the corporation by check made payable to The Peerless Canning Co. The other assets will be accepted by the corporation at the value stated; fixed assets will be accepted at their book value. When the transfer of cash and other assets mentioned on the Balance Sheet has been made, the facts shown on the Balance Sheet will be recorded in the general journal, and each partner will receive a certificate of stock for twelve hundred fifty shares, par value \$12,000.00, as evidence of his investment in the corporation.

The general journal entries at the right and the cash book entry below show the method of recording the authorization

September 1, 19

Page 1

√	Unissued Capital Stock		75000—				
	Capital Stock					75000—	
	To record the authorized capital stock.						
	1						
	Cash		2478 20				
	Notes Receivable		600 —				
	Accounts Receivable		4219 27				
	Factory Equipment		21916 65				
	Factory Supplies		321 80				
	Prepaid Insurance		129 50				
	Office Equipment		1250 —				
	Office Supplies		106 18				
	W. & J. C. Co., Vendors					31021 60	
	To record purchase of assets of W. & J. C. Co.						
	1						

W. & J. C. Co., Vendors

Notes Payable

Accounts Payable

To record the liabilities assumed from W. & J. C. Co.

1

W. & J. C. Co., Vendors

Unissued Capital Stock

To record the stock issued to the partners.

credited for the par value of the stock issued to the partners. Fixed assets are recorded at the book value because this is the cost price to the corporation.

The debits and credits to the account with W. & J. C. Co. Vendors are equal, hence, if desired, these entries may be checked and the posting omitted.

Page 2

CASH

Receipts

19									
Sept.	1	√	Unissued Capital Stock	See journal, page 1		2478	20		

When the general journal and cash book entries have been posted, the account balances in the ledger will show the authorized capital stock, the capital stock that may yet be issued, the assets received for the sale of stock issued, and the liabilities assumed by the corporation.

Closing the Ledger of a Going Concern. The entries in the illustration at the right show those required to record on the ledger of the Wilson & Jones Canning Co. the transfer of the assets and liabilities to the corporation. The first two entries record the sale of the assets and the transfer of the liabilities to the corporation, the third entry, the stock received from the corporation, and the fourth entry closes the partners' Capital accounts. When these entries are posted, all the accounts in the general ledger will be in balance. If the same ledger is used by The Peerless Canning Co., the same account titles may be used. The entries to close the accounts on the ledger of the Wilson & Jones Canning Co. are posted and the accounts that balance ruled before the opening entry of the corporation is posted.

August 31, 19

Peerless Canning Co.....	34124	—	
Cash			2478 20
Notes Receivable			600 —
Accounts Receivable.....			4219 27
Factory Equipment.....			24769 05
Factory Supplies			321 80
Prepaid Insurance.....			129 50
Office Equipment			1500 —
Office Supplies			106 18
To transfer the assets of W. & J. to The P. C. Co. 31			
Dep. Res. for Factory Equip.	2852	40	
Dep. Res. for Office Equip....	250	—	
Notes Payable	2500	—	
Accounts Payable	3521	60	
Peerless Canning Co.....			9124 —
To transfer the liabilities of W. & J. to The P. C. Co. 31			
Stock, Peerless Canning Co..	25000	—	
Peerless Canning Co.....			25000 —
To record the par value of The P. C. Co. stock. 31			
J. C. Wilson, Capital.....	12500	—	
J. W. Jones, Capital.....	12500	—	
Stock, The Peerless C. Co. To record the distribu- tion of P. C. Co. stock to the partners.			25000 —

Goodwill. Goodwill, as described by the United States Treasury Department, represents the value attached to a business over and above the value of the physical property after the liabilities are paid. For example, the proprietorship of a grocer in his stock and equipment may be \$10,000.00. He sells the business to a corporation for \$11,000.00. The corporation pays him \$11,000.00 because the store has goodwill, that is, people are accustomed to buying from it and will probably buy more from it than they would from a new business.

The asset goodwill is not of a tangible nature, hence it is usually referred to as an *intangible asset*. Its value is recorded in an account with the title *Goodwill*; it is recorded only when purchased. The asset may be continued on the books indefinitely or may be written off in future fiscal periods. If written off, it is not considered an expense of any one period, but is charged to the earnings of previous periods as shown by the Surplus account. The use of the Surplus account in this connection will be discussed later.

Goodwill may be purchased by a partnership as well as by a corporation. When purchased by a partnership, it is customary to adjust it through the partners' Capital accounts. When purchased by a corporation, it must be recorded in the Goodwill account because it cannot be adjusted through the Capital accounts.

Illustration. D. L. English owns the Busy Bee Restaurant. A corporation with an authorized capital of \$50,000.00 is organized to continue the operations. D. L. English receives stock at par, \$26,000.00, for his proprietorship; the corporation assumes the liabilities.

The proprietorship of D. L. English stated in equation form is:

ASSETS \$22,500.00 – LIABILITIES \$1,500.00 = D. L. ENGLISH, PROP. \$21,000.00

The assets consist of cash \$2,500.00 and equipment, book value, \$20,000.00; the liabilities, a note issued to the bank for a loan.

Since the proprietorship of D. L. English is only \$21,000.00 and he receives stock for \$26,000.00, the incorporators are paying him \$5,000.00 for goodwill.

The general journal entries at the right and the cash book entry below record (a) the authorization of capital stock, (b) the transfer of the assets, (c) the assumption of the liabilities, and (d) the issue of stock to D. L. English. The conditions here are the same as those in connection with the opening entry on page 282, hence the reason for the debits and credits is the same. The Goodwill account is debited for \$5,000.00, the amount paid D. L. English by the corporation for the goodwill of his business.

September 1, 19		PAGE 1	
	Unissued Capital Stock Capital Stock To record the authorized capital stock. 1	50000 —	50000 —
√	Cash.....	2500 —	
	Equipment.....	20000 —	
	Goodwill.....	5000 —	
	D. L. E., Vendor.....		27500 —
	To record purchase of assets of D. L. E. 1		
	D. L. E., Vendor.....	1500 —	
	Notes Payable.....		1500 —
	To record the liabilities assumed from D. L. E. 1		
	D. L. E., Vendor.....	26000 —	
	Unissued Capital Stock To record the stock issued to D. L. E.		26000 —

PAGE 2		CASH		Receipts	
19 Sept.	1 √	Unissued Capital Stock	See journal, page 1.	2500 —	

Sale of Stock at a Premium. Sometimes the stock in a corporation is offered for sale to the subscribers at a greater price than the par value. The purpose of this is to provide a surplus at the beginning of the business as additional working capital. When the subscribers agree to pay more than par value for the stock, it is necessary to record this excess when the subscription is recorded.

The Davis Company is granted a charter with an authorized capital stock of \$100,000.00, par value, \$100.00 a share. The promoters decide to offer this stock for sale to subscribers at \$25.00 a share above par. April 1, \$100,000.00 in cash has been received from stockholders for 800 shares at \$125.00 per share.

The entry to record the authorized capital stock in the general journal is made in the same form as in the illustration on page 284. The entry to record the cash received for the sale of stock at a premium is:

		CASH		Receipts	
19					
Apr.	1	Unissued Capital Stock	800 shares, par value, \$100	80000	—
	1	Premium on Capital Stock	800 shares, \$25	20000	—

When the journal and cash book entries are posted, the capital will be shown by the balances of the Capital Stock, Unissued Capital Stock, and Premium on Capital Stock accounts. The Premium on Capital Stock account is a proprietorship account, showing part of the original investment.

The promoters of a corporation may offer the stock for sale to subscribers at less than par value, unless prohibited by the law under which the corporation is organized. When stock is sold at a discount, the difference between the par value of stock and the cash received in payment for it will be debited to an account with Discount on Capital Stock.

Surplus. A corporation is organized because the stockholders expect to make a profit from the business it will operate. This profit will result from transactions completed by the corporation. The nature of the transactions completed will be the same as that of transactions completed by a similar business operated as a sole proprietorship or partnership.

The increases in proprietorship (income) and decreases in proprietorship (costs and expenses) are recorded in appropriate accounts which show the nature of the income, cost and expense. The balances of the e accounts (referred to as temporary proprietorship accounts) are summarized in a Profit and Loss Summary account. A debit balance of the Profit and Loss Summary account is the net loss and a credit balance the net profit resulting from operating the business during the fiscal period.

When the business is operated as a sole proprietorship or a partnership, the net profit is transferred to the owner's Capital account or to the Capital accounts of the partners in the proportion stated in the articles of copartnership. When the business is operated as a corporation, the net profit, which is the balance of the Profit and Loss Summary account, will not be transferred to the Capital Stock account, but to an account with Surplus. The reason for this is that earnings of a corporation can be paid as dividends but the invested capital can not. It is, therefore, necessary to record the earnings separately from the invested capital in order that the directors will be certain never to pay dividends out of capital.

The invested capital of a corporation is shown in the Capital Stock account, and the earnings in the Surplus account. For example, if a corporation

is organized with a capital stock of \$50,000.00 and assets are received from the incorporators for this amount, the proprietorship stated in equation form is:

$$\text{ASSETS } \$50,000.00 = \text{PROPRIETORSHIP } \$50,000.00$$

If at the end of the first fiscal period the total assets are \$73,000.00 and the total liabilities \$14,000.00, the equation is:

$$\text{ASSETS } \$73,000.00 - \text{LIABILITIES } \$14,000.00 = \text{PROPRIETORSHIP } \$59,000.00$$

In order that the board of directors will not pay out any of the capital as dividends, the equation may be restated as follows:

$$\text{ASSETS } \$73,000.00 - \text{LIAB. } \$14,000.00 = \text{PROP. } \$50,000.00 + \text{SURPLUS } \$9,000.00$$

Closing Entry for a Corporation. The closing entries for a corporation are the same as for a sole proprietorship or partnership except the one entry required to close the balance of the Profit and Loss Summary account. The balance of the Profit and Loss Summary account is closed into the Surplus

account through an entry in the general journal. The entry in the illustration at the left shows the method of transferring the \$9,000.00 earnings referred to in the foregoing illus-

December 31, 19			
	Profit and Loss Summary	9000	—
	Surplus		9000
	To close the P. and L. Summary account.		

tration from the Profit and Loss Summary account to the Surplus account. Should the corporation be operated at a loss, the Surplus account is debited and the Profit and Loss Summary account credited for the amount of the loss.

REPORT

Complete Report No. 68 in the work book and present to the instructor for approval. Continue with the text discussion until Report No. 69 is required on page 291.

CHAPTER XXIII

BOOKS OF RECORD PECULIAR TO A CORPORATION

The officers of the corporation are authorized by the board of directors to complete transactions with the stockholders of the corporation. The discussion in this chapter relates to the books of account in which the authority for the officers' actions and the transactions completed with stockholders are recorded.

Records for Transactions with the Stockholders. The stockholders in accordance with the authority given them in the charter, adopt by-laws and elect a board of directors to manage the business. The board of directors in turn elect officers (each of whom must be a stockholder) to represent it in transactions with stockholders, employees, creditors and customers. The records required for providing the needed information regarding the actions of the stockholders, board of directors and officers are as follows:

- Minute Book
- Subscription Book
- Subscribers Ledger
- Stock Certificate Book
- Stockholders Ledger
- Stock Transfer Book

Minute Book. The minute book contains a record of (a) the charter, (b) the by-laws, (c) the business transacted by the stockholders at their meetings, and (d) the business transacted at the meetings of the board of directors. The entries in the minute book are usually made by the secretary.

The stockholders usually adopt the by-laws and elect a board of directors at the first meeting when the corporation is organized. Subsequent meetings may be at any desired time; usually the stockholders hold at least one meeting each year. All business transacted by the stockholders which includes the by-laws, amendments to the by-laws, and election of the board of directors, is recorded in the minute book.

The board of directors elects officers and supervises their actions in connection with the operations of the corporation. Because of its close contact with the affairs of the corporation, the board of directors meets more often than the stockholders. The by-laws usually provide for regular meetings of the board of directors which may be weekly, monthly or quarterly, depending upon the nature of the business to be transacted by the board. Information regarding the call for regular and special meetings of the board of directors and the action of the board at its meetings are recorded in the minute book.

Entries in the minute book do not as a rule affect the accounting records. Should an action of the stockholders or board of directors affect the accounting records, information regarding this action will be referred to the accountant by the secretary, as a basis for the records. Thus, should the board of directors declare dividends, it will be necessary for the accountant to transfer from surplus a sufficient amount to pay the dividends. A notice from the secretary to the accountant regarding the amount of the dividends is sufficient authority for the accountant to record the amount as a debit to the Surplus account and a credit to the Dividends Payable account.

Subscription Book. When the corporation is to be organized, it is necessary for three or more of the promoters to make application for the charter. Usually those who promote the corporation, plan for financing it. This financing involves securing the assets to be invested by the proposed stockholders. The usual plan of promotion is to prepare a subscription list and have those who wish to invest sign this list stating the value of the assets to be invested.

Those who sign the subscription list are known as *subscribers* and each

becomes a debtor to the corporation for the value of the stock subscribed after the charter is granted. The usual terms of subscription is cash upon demand but the terms may be on the deferred payment plan. Since the corporation is usually required to have available at the time the charter is granted assets for at least 50% of the par value of the stock subscribed, it is customary to collect half of the subscription when the subscriber signs the subscription list and the remainder at the time the charter is granted.

SUBSCRIPTION LIST				
We, the undersigned, hereby subscribe for the number of				
shares of stock in the corporation known as.....				
THE WAYMAN MERCANTILE COMPANY....., set opposite our names				
and agree to pay for same, upon demand.....				
Date		No. of Shares	Par Value	Signature
Aug	15	130	13,000.00	B. A. Wayman
	15	50	5,000.00	G. W. Hamilton
	20	50	5,000.00	J. H. Watson
	24	10	1,000.00	B. A. Grogg
	27	10	1,000.00	W. J. Wayman

Illustration 68, Subscription Book

for each subscriber or a sheet of paper containing the names of the subscribers as in the illustration above. The statement in connection with the subscription includes the terms of the subscription. The binder in which the various subscription cards or subscription lists are filed constitutes the subscription book. The information contained in this book provides a basis for recording the subscriptions.

The subscription list may be a separate card

Recording Transactions with Subscribers. The subscription list forms a basis for the transactions with each subscriber. When the terms are cash or half cash with the balance to be collected when the corporation is organized, no account is needed with the individual subscribers. On the other hand, if the terms are on the deferred payment plan, it will be necessary to maintain an account with each subscriber. The basis for the information in this account may be the subscription list and the cash book entry to record the cash collected from the subscriber or the information on the list may be recorded in a stockholders journal ruled similar to the sketch below.

Date	No. of Shares	By Whom Subscribed	Terms	Par Value of Subscription

If the stock subscribed is no par value, the column marked "Par Value Stock Subscribed" will be "No. of Shares Subscribed" and an additional column at the right of this with the value of the stock subscribed.

The cash collected from subscribers may be recorded in the general cash book or in a special cash book known as the *subscribers cash book*. When the subscribers cash book is used, the total entered in this book is transferred to the general cash book either when the cash is deposited or at the end of the month. An account with the title Subscriptions Receivable is debited for the amount of the subscriptions and credited for the cash collected; it is a controlling account in the general ledger for the accounts with the subscribers in the subscribers ledger.

Subscribers Ledger. Usually when stock is subscribed on the deferred payment plan, there are a number of subscribers. For this reason it is customary to maintain the accounts with the subscribers in a subsidiary ledger known as the *subscribers ledger*. The debits to the accounts in the subscribers ledger are posted from the subscription list or the subscribers journal and the credits from the general cash book or the subscribers cash book. The balance of each account in the subscribers ledger shows the amount to be collected from him. When the account is in balance, it indicates that the subscriber has now become a stockholder and his account transferred to the stockholders ledger.

Stock Certificate Book. Each stockholder in a corporation has a receipt for his investment in the form of a stock certificate. He can sell or transfer all or a part of the stock indicated by the certificate to another person. This transfer can be made without the consent of anyone else connected with the corporation and without in any way affecting the affairs of the corporation. This is quite different from the transfer of ownership in a partnership for a partner can not dispose of or transfer his proprietorship without the consent of the other partner or partners.

At the time a corporation is formed, the stock certificate book consists of a number of blanks provided for issuing stock certificates to stockholders. Each blank consists of two parts, (a) the stub and (b) the certificate; the stub is

provided for information needed by the corporation and the certificate for that needed by the stockholder. The corporation needs to know to whom each certificate is issued, his address, and the number of shares issued to him. The stockholder needs to know the name of the corporation, the authorized capital stock, and in the case of par value stock, the par value of each share.

The illustration below shows a stock certificate and stub. Certificates are signed by the officers of the corporation authorized to issue stock and the stub is signed by the stockholder as a receipt and record of his signature; the signature of the stockholder is not always required.

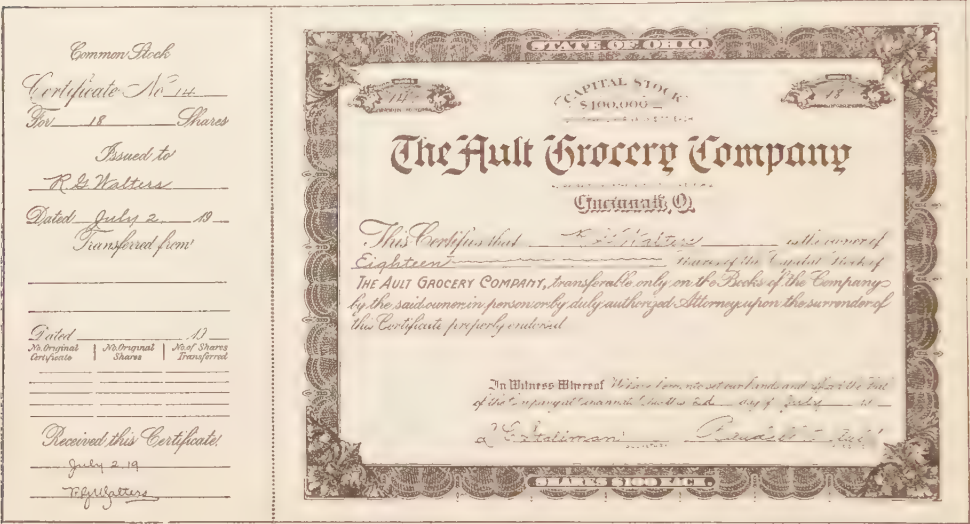


Illustration 69, Stock Certificate

The illustration at the left shows the back of a certificate of stock. This form is for information relating to the transfer of the certificate by the holder.

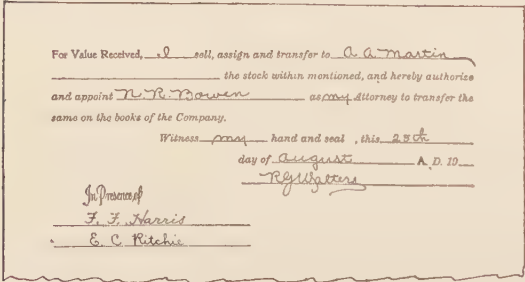


Illustration 70, Back of Stock Certificate

for a certificate purchased, the old certificate is canceled and filed either by attaching it to the stub of the certificate from which it was removed or placing it in a file provided for this purpose.

This transfer is through an authorized officer of the corporation. When stock in a corporation is purchased from a stockholder, the purchaser should have the stock transferred on the books of the corporation at once so that he may receive any dividend declared by the board of directors. When a new certificate has been issued to a stockholder in exchange

When a stockholder wishes to transfer only a part of the stock stated in his certificate, it will be necessary for him to authorize an officer of the corporation to issue two certificates, a new one to himself for that part of the stock which he retains and one to the stockholder to whom he has transferred a part of his stock. The original certificate is canceled and full information regarding the stock issued each stockholder is shown on the stubs from which the new certificates are removed.

Stock Transfer Book. The stock certificate stub may be used as a basis for a record of the transactions with each stockholder or the information on the stub recorded in a special journal known as a *subscribers journal* or *stock transfer book*. When the stock of a corporation is listed on a stock exchange, it is customary to appoint a bank in the city where the exchange is located as transfer agent for the corporation and to provide this bank with a stock transfer book with authority to issue stock certificates to those who have purchased the stock on the exchange.

DATE	SERIAL No OF CANCELED CERTIFICATE	No. OF SHARES	BY WHOM SURRENDERED	TO WHOM ISSUED	SERIAL No OF NEW CERTIFICATE	No OF SHARES	No AND FACE VALUE OF STAMPS				
							2c	4c	\$1	ETC	VAL.

Illustration 71, Stock Transfer Book

Stockholders Ledger. The ledger which contains an account with each stockholder showing the number of shares of stock owned by him is referred to as the *stockholders ledger*. The title of each account in this ledger is the name and address of the stockholder. The information recorded in each account is the number of shares issued to a stockholder by the corporation and the number of shares transferred by him to another stockholder; the par value of each share may also be recorded if desired. See Illustration 72 below.

James O. Whitman
1229 Glenview Ave., City

DATE	No. OF CERT	FROM WHOM OBTAINED OR TO WHOM TRANSFERRED	NO. OF NEW CERT.	DATE OF ASSIGNMENT	DEBIT FOR CREDIT FOR		
					SHARES TRANS.	SHARES OBTAINED	CREDIT BALANCE
1922 July	2	- Original Issue	14			18	18
Aug.	3	H. S. Coulter	17	Aug. 3	4	-	14

Illustration 72, Stockholders Ledger

REPORT

Complete Report No. 69 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 70 is required on page 298.

CHAPTER XXIV

ACCOUNTS PECULIAR TO A CORPORATION

The corporate records discussed in the preceding chapter provide a basis for the information to be recorded in the accounts. The discussion in this chapter relates to the accounts required in the operation of the corporation because the business is incorporated. The purpose of these accounts is to contain a record of the transactions which the officers of the corporation through authority of the board of directors complete with the stockholders. This discussion is a summary of the three preceding chapters.

Corporate Accounts. The usual accounts required to record the transactions completed by the corporation with its stockholders are *Capital Stock*, *Unissued Capital Stock*, *Surplus*, *Dividends Payable*, *Treasury Stock*, *Subscriptions Receivable* and *Capital Stock Subscribed*. Other accounts may be required. These include *Paid In Surplus*, *Capital Surplus*, *Organization Expense*, *Goodwill* and *Bonds Payable*. The accounts required to contain a record of the transactions completed by the corporation with creditors, customers and others with whom it may have dealings are the same as those kept by a business of a similar nature operated as a sole proprietorship or a partnership.

Authorized Capital Stock. The charter states the number of shares of stock which the corporation is authorized to issue and the par value of the stock, if it has a par value. The corporation is not required to issue all the authorized stock at the time of organization and it can not issue a greater number of shares of stock than authorized by the charter. The corporation may reduce its stock at any time a majority of stockholders elect to do so but it can not increase the number of shares authorized without an amendment of the charter by the authority which granted it.

To avoid the possibility of issuing more stock than authorized, it is customary at the time the corporation is organized to record the authorized capital stock. The Unissued Capital Stock account is *debited* for the par value of par value stock authorized and the Capital Stock account *credited* for the same amount. The Unissued Capital Stock account is *credited* for the par value of stock issued to stockholders. The Unissued Capital Stock account can not be used for no par value stock; the Capital Stock account is credited for the selling price of this stock at the time it is sold.

The Capital Stock Account is a record of the increases and decreases in the amount of capital stock (shown at par) which the corporation is authorized to issue. This account is *credited* for (a) the par value of the total

authorized capital at the time the corporation is organized and (b) the par value of the increases as authorized by an amendment to the charter. The Capital Stock account is *debited* for decreases in the amount of capital stock (at par) as authorized by the stockholders.

When debited and credited as described, the *credit* balance of the Capital Stock account shows the par value of the authorized capital. It is shown on the Balance Sheet in connection with the proprietorship of the corporation.

When the corporation is authorized to issue no par value stock, the credit to the Capital Stock account is the selling price of the stock for the number of shares issued. The number of shares authorized is shown in connection with the title of the account.

The Unissued Capital Stock Account is a record of the amount of capital stock authorized but not yet issued. This account is *debited* for the amount of the authorized capital stock (at par) at the time the corporation is organized and *credited* for the amount of the capital stock (at par) issued to stockholders from whom the invested assets have been received per agreement.

When the Unissued Capital Stock account is debited and credited as described, the *debit* balance will show the amount of the capital stock valued at par which the corporation is yet authorized to issue. It is shown on the Balance Sheet as a deduction from the capital stock authorized as shown by the Capital Stock account to ascertain the amount of the capital stock outstanding.

When the corporation is authorized to issue no par value stock, the Unissued Capital Stock account is not used. In this case the Capital Stock account is not credited until stock is issued and then only for the amount received.

Surplus and Dividends. The net increase in the amount of corporate property as a result of transactions is a profit referred to as surplus, and the decrease, a loss or deficit. As explained on page 285, the profit or loss is transferred from the Profit and Loss Summary account to the Surplus account at the close of the fiscal period. The credit balance of the Surplus account shows the amount of accumulated profit available for dividends.

The board of directors are elected by the stockholders to supervise the operations of the business and determine the distribution of the profit. The board of directors may distribute corporate assets to the stockholders but the amount of this distribution must not exceed the net profit as recorded in the credit balance of the Surplus account. This authorized division of assets among the stockholders is referred to as a *dividend* and the action of the board authorizing the distribution, as *declaring a dividend*. On par value stock, the dividends may be a designated amount per share or a per cent of the par value; on no par value stock, the dividends are a designated amount on each share. Dividends are declared only on stock issued and outstanding.

The declaration of a dividend by the board of directors results in an increase in the liability *dividends payable* for the amount of the dividend and a

A part of the surplus is sometimes distributed to the stockholders in stock certificates; this is referred to as a *stock dividend*. A stock dividend differs from a cash dividend in that the corporate assets are not affected. A stock dividend is recorded as a debit to the Surplus account for the amount of the dividend and a credit to the Unissued Capital Stock account for the same amount.

decrease in the credit balance of the Surplus account for the same amount. Dividends are usually paid in cash. The payment of a dividend results in a decrease in the liability dividends payable and a decrease in the asset cash.

The Surplus Account is a record of the profit or loss resulting from the operation of the corporation. This account is *credited* at the close of each fiscal period with the net profit or *debited* at the close of a fiscal period with the net loss or deficit. During the fiscal period, the Surplus account is *credited* for any errors made in a previous period which increase the profit recorded in it and *debited* for any errors made in a previous period which decrease the profit recorded in it. The Surplus account is also *debited* for the amount of each dividend declared and for any amounts taken out of surplus and set aside for a specific purpose.

After having been debited for decreases (*net loss*, correction of errors in previous Profit and Loss accounts when the profit was overstated, *dividends declared*, and funds set aside for a *specific purpose*) and credited for increases (*net profit* and correction of errors in previous Profit and Loss accounts when the profit was understated) the *credit* balance of the Surplus account will show that part of the profit which has not been declared as dividends. It is shown on the Balance Sheet as a part of the corporate proprietorship.

The Dividends Payable Account shows the liability of the corporation to the stockholders for the payment of dividends declared by the board of directors. This account is *credited* for the amount of each dividend on the date declared and *debited* when these amounts are paid to stockholders.

The *credit* balance of the Dividends Payable account shows the amount owing to one or more stockholders who have not yet received the dividends. It is one of the current liabilities and shown as such on the Balance Sheet.

It is customary to designate each dividend by number and indicate this number in the title of the account or in the explanation column of the Dividends Payable account. Thus, the title of the account in which the first dividend is recorded may be Dividends Payable No. 1, the second one Dividends Payable No. 2, the third one Dividends Payable No. 3, etc. Unless the account titles are described in this manner, the title would be Dividends Payable, with No. 1, No. 2, No. 3, etc., written in the explanation column of the account.

Subscriptions Receivable. As explained on page 289, a subscriber's promise to make investments in the corporation on the installment plan increases the asset subscriptions receivable and increases the liability capital stock subscribed. A subscription on the installment or deferred payment plan is recorded as a debit to the Subscriptions Receivable account and a credit to the Capital Stock Subscribed account.

Cash received from a subscriber as a part of his investment results in an increase in the asset cash and a decrease in the asset subscriptions receivable. When the full amount which the subscriber has agreed to invest has been collected from him, the corporation fulfills its promise through issuing stock to him. The issuing of stock to a subscriber results in a decrease in the amount of the capital stock the corporation has promised to issue and a decrease in the capital stock it has available for issuing. The Capital Stock Subscribed

account is debited to record the subtraction from the amount which the corporation has promised to issue and the Unissued Capital Stock account is credited to record the decrease in the amount of capital stock not yet issued.

The Subscriptions Receivable Account is a record of the increases and decreases in the asset subscriptions receivable. When subscriptions for stock are received this account is *debited* and when cash is received from the subscribers, this account is *credited*.

The *debit* balance of the Subscriptions Receivable account shows the amount still to be collected from subscribers. It is one of the current assets of the corporation and shown as such on the Balance Sheet.

The Capital Stock Subscribed Account is a proprietorship account which shows a record of the increases and decreases in the corporate liability to stockholders to issue stock at some time in the future. This account is credited for subscriptions received on the deferred payment plan and debited for the par value or selling price, if no par value stock.

The *credit* balance of the Capital Stock Subscribed is shown on the Balance Sheet as a part of the proprietorship.

If the Balance Sheet is prepared before any stock has been issued because collection has not been made in full from subscribers, the credit balance of the Capital Stock Subscribed account will show all the invested capital at that time.

Bonds. The board of directors are responsible to the stockholders for the operations of the business. Should temporary capital be needed, the board authorizes the officers to secure this property through a short-time loan at the bank or through a long-time loan usually referred to as *bonds*.

A bond is a long-time note authorized by action of the board of directors and executed by the officers of the corporation. The purpose of the bond issue is to secure assets for use in the operation of the business. When a bond issue is made, it is customary to issue a number of bonds of denominations of \$100.00, \$500.00, or \$1,000.00. The sum of the face value of the various bonds is equal to the total of the bond issue.

A bond issue is made for a term of years, usually ten years or more. Coupon bonds have attached to each bond coupons for the annual or semi-annual interest. Registered bonds state the interest rate and date of payment but the holder must register the bond with the company issuing it or its trustee and receive his interest at the agreed time.

The Bonds Payable Account is a record of the increases and decreases in the liability bonds payable. This account is *credited* for the face value of the bonds when they are issued and *debited* for the face value of any bonds paid off.

The *credit* balance of the Bonds Payable account shows the amount of the liability bonds payable still unpaid. It is one of the fixed liabilities of the corporation and shown as such on the Balance Sheet.

A fixed liability is one which is payable a comparatively long time after the debt is contracted. Fixed liabilities differ from current liabilities in that current liabilities are payable in a short time, usually early in the next fiscal period.

Organization Expense. The expense incurred in connection with organizing a corporation is known as *organization expense*. This expense includes legal fees, commission, office rent and similar expenses incurred before the corporation is ready to begin business.

Ordinarily expenses are not considered to be assets, but Organization Expense is an asset of a nature similar to deferred charges. It may be carried on the books permanently as an asset although many companies write it off over a number of fiscal periods. If it is charged off, it is not considered an expense of any one fiscal period, but is charged to Surplus.

While organization expense is an asset yet it is of an intangible nature, hence it is referred to as an intangible asset. In this respect it differs from such deferred assets as Supplies and Prepaid Insurance.

The Treasury Department has ruled that organization expense can not be regarded as an operating expense, that is, a deduction from the operating income for one or more fiscal periods. It may, however, be written off as a debit to the Surplus account.

The Organization Expense Account is a record of the asset organization expense. This account is *debited* at the time the corporation is ready to begin business for the total expenses required in connection with the organization, and *credited* at the close of each fiscal period for the amount which the board of directors authorizes to be charged off.

The *debit* balance of the Organization Expense account shows the amount of the deferred asset organization expense yet to be charged off. It is shown on the Balance Sheet after the fixed assets; it is not shown with the deferred assets because it does not have the same meaning as supplies or prepaid insurance.

The Goodwill Account is a record of the goodwill purchased by the corporation in connection with the purchase of a going business as explained on page 283. The Goodwill account is *debited* at the time of purchase for the cost of the goodwill. It is an intangible asset and shown on the Balance Sheet as a fixed asset.

The amount paid for goodwill may be allowed to remain in the Goodwill account or it may be charged off through Surplus in the same manner as organization expense. It cannot be regarded as an operating expense and deducted from operating income; this statement applies whether the goodwill is recorded on the ledger of a partnership or a corporation. In the case of a partnership the goodwill is charged off through the capital accounts.

The cost of obtaining a copyright is debited to an account with Copyrights, and a patent right, to an account with Patent Rights. These accounts contain a record of intangible assets of the same nature as goodwill. When charged off over a period of years, the amount of the decrease in the asset value of the copyright or patent right applicable to each year may be recorded as an expense deductible from the income for the year.

Treasury Stock. The law under which a charter is issued usually prohibits the corporation from buying its own stock except under certain conditions. When it is necessary to purchase the stock under these conditions, the

stock so purchased must be sold within a designated time, usually one year. This purchase of its own stock by a corporation results in a decrease in the assets and a corresponding decrease in the capital stock outstanding for the par value of the stock purchased. Stock which comes into the possession of the corporation through transactions of this nature is referred to as *treasury stock*. It is customary to record the par value of treasury stock in an account with the title *Treasury Stock*.

Treasury stock has the same meaning to the corporation as unissued capital stock in that it is a deduction from the authorized capital stock recorded in the Capital Stock account. Neither treasury stock nor unissued capital stock have an asset value. The sum of the par value of unissued capital stock and treasury stock is deducted from the capital stock authorized to ascertain the par value of the capital stock outstanding.

Treasury stock may also come into the possession of the corporation through donation by stockholders. The meaning of treasury stock is the same whether it is purchased or received from a stockholder as a donation.

Donated Treasury Stock. Should the stockholders wish to secure additional assets as an investment in the corporation without increasing the capital stock outstanding, they may donate a part of their stock to be sold by the corporation. Stock donated to the corporation by its stockholders does not change the assets, liabilities or proprietorship of the corporation but it does reduce the amount of the capital stock outstanding. A record of this should be made on the ledger in order that the par value of the outstanding capital stock may be shown by account balances. The usual plan is to record the par value of the stock donated as a debit to the Treasury Stock account and a credit to an account with the title Donated Surplus.

May 10. The stockholders of the May Store, Inc., agreed to donate stock with a par value of \$10,000.00.

The entry to record the needed facts on the ledger is in the illustration at the right. The debit to the Treasury Stock account records the decrease in the outstanding stock; the credit to Donated Surplus records the increase in invested capital.

May 10, 19			
Treasury Stock	10000	—	
Donated Surplus			10000
100 shares of stock donated by stockholders.			

May 20. The May Store received \$10,000.00 in cash for stock issued as authorized by the donation May 10.

This transaction results in an increase in assets and a corresponding increase in capital stock outstanding. The Cash account is debited to record the increase in assets and Treasury Stock credited to record the increase in

stock outstanding. The entry to record the sale of this stock on the receipts side of the cash book is:

		CASH	Receipts
19 May 20	Treasury Stock	Donated stock	10000 -

If the May Store received only \$9,000.00 cash for the stock sold, the amount of donated surplus is decreased \$1,000.00 hence the Donated Surplus account is debited for \$1,000.00. The entry to record all the facts regarding the transaction in general journal form is illustrated at the right. The debit to the Cash account records the increase in assets, the debit to Donated Surplus, the decrease in invested capital, and the credit to Treasury Stock, the sale of the stock.

May 20, 19			
Cash.....	9000		
Donated Surplus.....	1000		
Treasury Stock.....			10000
To record the sale of donated treasury stock at \$90.00 per share.			

The Treasury Stock Account is a record of the corporation's own stock which has once been issued and is again owned by the corporation. This account is *debited* when such stock is purchased by or donated to the corporation and *credited* when this stock is sold. Entries in this account are always at par. The *debit* balance of the Treasury Stock account shows the amount of stock in the treasury (valued at par) available for sale to stockholders. It is shown on the Balance Sheet as a deduction from the balance of the Capital Stock account because it reduces the amount of the capital stock outstanding.

Donated Surplus Account. The purpose of the Donated Surplus account is to show additional investment beyond the par value of the outstanding capital stock caused by stock donations. This account is *credited* at par value when stock is donated to the corporation. The *credit* balance is shown on the Balance Sheet as a part of the proprietorship. When the donated stock is sold, this surplus account may have to be increased or decreased depending upon the selling price of the stock.

When all of the capital stock authorized has been issued and the stockholders desire to increase the invested capital, they may invest additional assets instead of donating stock. The investment of these assets results in an increase in the assets and a corresponding increase in the invested capital. Cash or the account which shows the value of the assets invested is debited and an account with *Paid In Surplus* credited.

REPORT

Complete Report No. 70 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 71 is required on page 308.

CHAPTER XXV

WORK AT THE CLOSE OF THE FISCAL PERIOD

The discussion in this chapter is a review of Chapters VI, XIII and XX. The information in the chapters referred to in the preceding sentence related to a business organized as a sole proprietorship or partnership; the information in this chapter relates to a business operated as a corporation.

Corporate Transactions. In the operation of a corporation, transactions will be completed with (a) stockholders, and (b) creditors, customers and others with whom the corporation does business. The nature of all transactions completed by a corporation, except those with stockholders, is the same as those completed in a similar business operated as a sole proprietorship or a partnership. At the beginning of each fiscal period, the account balances in the general ledger stated in equation form are:

$$\text{ASSETS} = \text{LIABILITIES} + \text{CAPITAL STOCK} + \text{SURPLUS}$$

Each transaction completed during a fiscal period affects either the (a) assets, (b) liabilities, (c) assets and liabilities, (d) assets and proprietorship, (e) proprietorship, (f) assets and income or expense, or (g) liabilities and income or expense. Each transaction is recorded so as to show its effect on assets, liabilities and proprietorship as follows:

DEBITS

- (1) Increases in assets.
- (2) Decreases in liabilities.
- (3) Decreases in proprietorship.
- (4) Increases in expense.
- (5) Decreases in income.

CREDITS

- (1) Decreases in assets.
- (2) Increases in liabilities.
- (3) Increases in proprietorship.
- (4) Decreases in expense.
- (5) Increases in income.

Chart of Accounts. As explained in Chapter XX, the accountant prepares a chart of the accounts required in each business at the time the business is organized. This chart includes a list of the account titles classified as in the charts on pages 248 and 300; the two charts are the same except that on page 300 the income or increases in proprietorship are grouped together followed by the costs and expenses or decreases in proprietorship. The chart on page 300 contains the accounts required by the Ault Grocery Co. by whom you will be employed as chief accountant in completion of the Part 4 Practice Set. The discussion in this chapter is based on this chart of accounts and illustrations which follow it; the illustrations relate to the work required at the close of the monthly fiscal period ending June 30.

Numbering Accounts. When preparing a chart of accounts, it is customary with accountants to describe each account by title and by number. This plan facilitates recording transactions and provides a ready reference to each account on the chart. The numbers at the left of each account title in this chart provide the same information regarding the account as the title.

BALANCE SHEET ACCOUNTS

1. ASSET ACCOUNTS

11. *Current Assets*

- 111. Cash (City National Bank)†(316)
- 112. Petty Cash (241)
- 113. Securities (301)
- 114. Notes Receivable (104)
- 1104. Notes Receivable Discounted (187)
- 115. Accrued Interest on Notes Receivable (220)
- 116. Accounts Receivable (230)
- 1106. Reserve for Bad Debts (216)
- 117. Subscriptions Receivable (295)
- 118. Mdse. Inventory (ending) (131)
- 119. Branch Store (301)

12. *Deferred Assets*

- 121. Office Supplies (203)
- 122. Postage (203)
- 123. Warehouse Supplies (203)
- 124. Prepaid Insurance (204)
- 125. Prepaid Int. on Notes Pay. (204)
- 126. Funds in Hands of Salesmen (302)

13. *Fixed Assets*

- 131. Office Equipment (215)
- 1301. Dep. Res. for Office Equip. (215)
- 132. Warehouse Equipment (215)
- 1302. Dep. Res. for Ware. Equip. (215)
- 133. Delivery Equipment (215)
- 1303. Dep. Res. for Del. Equip. (215)

14. *Intangible Assets*

- 141. Goodwill (296)
- 142. Organization Expense (296)
- 143. Patent Rights (296)

2. LIABILITIES

21. *Current Liabilities*

- 211. Notes Payable (109)
- 212. Accrued Interest on Notes Payable (226)
- 213. Accounts Payable (233)
- 214. Accrued Expenses (227)

22. *Fixed Liabilities*

- 221. Bonds Payable (295)

3. PROPRIETORSHIP

- 31. Capital Stock (292)
- 301. Unissued Capital Stock (293)
- 301-a. Treasury Stock (298)
- 32. Capital Stock Subscribed (295)
- 33. Paid In Surplus (298)
- 34. Surplus (294)

P. AND L. STATEMENT ACCOUNTS

4. INCREASES IN PROPRIETORSHIP

41. *Operating Income (Trading)*

- 411. Sales (135)
- 4101. Sales Returns and Allow. (135)

42. *Non-Operating Income*

- 421. *Profit on Operations of Branch Store (301)
- 422. Purchases Discount (140)
- 423. Interest Income (105)

5. DECREASES IN PROPRIETORSHIP

51. *Cost of Merchandise Sold (Trading)*

- 511. Purchases (131)
- 5101. Purchases Ret. and Allow. (131)
- 512. Freight In (131)

52. *Operating Expenses*

521. *Selling Expenses*

- 5211. Sales Salaries (250)
- 5212. Salaries of Traveling Men (249)
- 5213. Traveling Expense (249)
- 5214. Warehouse Expense (249)
- 5215. Warehouse Supplies Used (204)
- 5216. Dep. on Warehouse Equip. (216)
- 5217. Misc. Selling Expense (249)
- 5218. Drivers Wages (249)
- 5219. Dep. on Delivery Equip. (216)
- 52110. Expired Ins. in Del. Equip. (204)
- 52111. Misc. Delivery Expense (249)

522. *General Expenses*

- 5221. Rent (250)
- 5222. Office Salaries (250)
- 5223. Office Supplies Used (204)
- 5224. Postage Used (204)
- 5225. Depreciation on Office Equipment (216)
- 5226. Expired Insurance (204)
- 5227. Loss on Bad Debts (216)
- 5228. Misc. General Expense (250)

53. *Non-Operating Expense*

- 531. Sales Discount (142)
- 532. Interest Expense (109)
- 533. Donations (302)
- 534. Loss on Exchange of Fixed Assets (213)

*This may be classified as an operating income if desired.

†Refers to the page in this text on which the account is discussed.

Referring to the illustration you will observe that the five general classifications are indicated by the digits 1, 2, 3, 4, 5. The classification in each group is indicated by the second digit or the second and third digits depending upon the number of accounts in the group. Each account which is shown on the Balance Sheet or Profit and Loss Statement as a deduction from another account is given the number of the account to which it is applicable preceded by a cipher. Thus, asset accounts are No. 1; current asset accounts, No. 11; and Cash, the first current asset, No. 111, with Merchandise Inventory the eighth current asset, No. 118. Accounts Receivable, the sixth current asset is No. 116 and the Reserve for Bad Debts, a deduction from it, is No. 1106, the cipher indicating that it is a deduction from account No. 6 in Group 11.

Using the chart as a basis, if it is desired to record a cash expenditure as a debit to Warehouse Salaries, the description would be debit account No. 5214 and credit account No. 111. Reference to the chart permits a ready interpretation of the accounts affected. Thus, if an exchange of office equipment is made which involves a cash payment and a loss, the account titles debited are Nos. 131, 1301, and 534 and the accounts credited, Nos. 111 and 131.

Manual of Accounts. After preparing the chart of accounts, the accountant will prepare a manual to accompany it. This manual contains a description of the transactions to be recorded in each account. The information which would be contained in the manual is provided you through the text. The number at the right of each account title on page 300 refers to the page in this text on which the information regarding the account as it would appear in the manual is to be found.

Those accounts which have not been discussed are as follows: Securities, Branch Store, Funds in Hands of Salesmen, and Donations. The information which would be contained in the manual in regard to these accounts is as follows:

Securities Account. The purpose of this account is to contain a record of temporary investments in the form of stocks, bonds, certificates of deposit or call loans. These temporary investments are to secure interest on funds which are used in the operations of the business but are not required for immediate use.

The Securities account is *debited* for the face value (or cost) of any securities purchased and *credited* for the face value (or cost) of securities sold or collected. The interest earned on the securities is credited to the Interest Income account when collected or accrued, or when the securities are sold.

The *debit* balance of the Securities account shows the amount of securities owned by the corporation and is shown on the Balance Sheet as one of the current assets; the accrued interest at the close of the fiscal period is also an asset.

Branch Store Account. The purpose of this account is to contain a record of the transactions with the branch store. A branch store is one operated by the business separate from its main operations and with the purpose of securing an additional income to that earned by the main store.

The Branch Store account is *debited* for the assets transferred to it which includes merchandise and cash and for the assets given to others for the branch

store which includes cash for rent, insurance, etc. The Branch Store account is *credited* for assets received from it which includes cash and returned merchandise. The *debit* balance of the Branch Store account shows the value of the assets which should be on hand at the branch store if there has been no profit or loss. If a physical inventory of these assets is greater than the debit balance of the account, the difference is the profit resulting from operating the store.

At the close of the fiscal period the Branch Store account is debited with the profit or credited with the loss so that its balance will show the value of assets in the branch store at the beginning of the next fiscal period. This *debit* balance is shown on the Balance Sheet as one of the current assets.

If a large amount of deferred and fixed assets are used in the branch store, these may be recorded in separate accounts in which case there would be shown on the Balance Sheet in connection with the branch store three accounts (a) Branch Store Current Assets, (b) Branch Store Deferred Charges, and (c) Branch Store Fixed Assets.

Funds in the Hands of Salesmen. When sales are secured through the services of road men, it is customary for the firm to pay the expenses of each salesman. The usual plan is to advance funds and have the salesman report his expenditures weekly, semi-monthly, or monthly.

The account with each salesman is *debited* for the amount of cash advanced and *credited* for the amount of his weekly, bi-monthly, or monthly expenses as reported. The *debit* balance of the account with each salesman will show the amount of the unexpended funds on hand.

At the close of the fiscal period the debit balances of the accounts with salesmen will show the total amount of unexpended funds in their hands. These account balances are shown on the Balance Sheet as a deferred charge under the title Funds in the Hands of Salesmen.

Donations. Individuals, partnerships and corporations engaged in business will be called upon to make donations for charitable purposes. Each donation results in a decrease in the assets and proprietorship. The decrease in proprietorship is usually recorded in an account with the title Donations.

The Donations account is *debited* with decreases in proprietorship due to donations of assets. This account is usually not *credited*. The *debit* balance shows the total amount of donations.

At the close of the fiscal period the *debit* balance of the Donations account is shown on the Profit and Loss Statement as an expense and closed into the Profit and Loss Summary account. Individuals and partnerships may regard donations as a deduction from income earned but corporations are not permitted to do so.

Trial Balance. The account balances in the Trial Balance columns of the Work Sheet, Illustration 73, are from the ledger of the Ault Grocery Co. at the close of the June fiscal period. The equality of debits and credits in the ledger has been maintained as indicated by the fact that the Trial Balance balances.

Work Sheet. The information in the ten columns at the right of the Trial Balance are the result of the adjustments because of the changes in assets, liabilities and proprietorship which were not recorded at the time the changes occurred during the fiscal period. The Adjustments columns provide a basis for recording these changes in the general journal also a means of ascertaining net profit, present proprietorship and proof of their correctness. The information used as a basis for the adjusting entries is as follows:

Merchandise inventory, \$31,974.09; branch store inventory, \$8,458.72; office supplies inventory, \$198.60; postage inventory, \$38.45; warehouse supplies, \$87.19; expired insurance on delivery equipment, \$11.75 and on merchandise, \$40.55; accrued interest on notes receivable, \$3.41; prepaid interest on notes payable, \$45.67; accrued interest on notes payable, \$5.94; depreciation on warehouse equipment, \$1.15; depreciation on office equipment, \$2.75; depreciation on delivery equipment, \$100 00; reserve for bad debts, \$16.79.

Work Sheet Extensions. Twelve columns are provided. The purpose of each column is indicated by the title at the top. The basis for the extensions is the information in the manual of accounts; see chart on page 300. The adjustments are recorded in the Adjustments columns and all account balances, which includes those on the Trial Balance and those affected by the adjustments, extended into the Adjusted Trial Balance columns. The balance of each account in the Adjusted Trial Balance columns is an asset, liability, capital, trading, income, expense or a minus asset, capital or trading. Minus assets include reserves for depreciation and bad debts, discounted notes, etc. These account balances are extended into the Trading, Profit and Loss Statement, and Balance Sheet columns according to the nature of the information shown by the account.

Proof of Correctness. The Adjustments columns are footed to prove that the equality of debits and credits has been maintained in recording the adjustments. The Adjusted Trial Balance columns are footed to prove that the equality of debits and credits has been maintained in making the extensions and the adjustments. The Trading columns are footed to ascertain the gross trading profit; this amount is entered in the credit Profit and Loss Statement column because it is the profit. The Profit and Loss Statement columns are footed to ascertain the net profit; this amount is extended into the credit Balance Sheet column because it is an increase in proprietorship. The Balance Sheet columns are footed to ascertain the present proprietorship.

The extensions in the twelve-column Work Sheet illustrated are the same as those in all preceding Work Sheets. You must keep in mind the fact that the number of columns on the Work Sheet does not change the principles involved but only provides more information for the adjusting and closing entries and proof of more facts in connection with the Work Sheet. Four columns in addition to those in the illustration may be provided, two for the closing entries and two for the Post-closing Trial Balance. Space will not permit including these additional columns in the illustration.

*Robt. Hancock Company
Main Street, June 30, 19--*

NAME OF ACCOUNT	TRIAL BALANCE		ADJUSTMENTS		ADJ. TRIAL BALANCE		TRADING		P. & L. STATEMENT		BALANCE SHEET	
	DR	CR	DR	CR	DR	CR	DR	CR	EXP	INCOME	ASSETS	LIAB & PROP
City National Bank	12,140.18				12,140.18						12,140.18	
Petty Cash	20				20						20	
Certificate of Deposit	5000				5000						5000	
Notes Receivable	1944.30				1944.30						1944.30	
Accrued Int on Notes Pay			341			341						341
Accounts Receivable	15370.84				15370.84						15370.84	
Reserve for Bad Debts		112.14		10.79		122.93						122.93
Merchandise Inventory	29416.27				29416.27		20416.27	31074.99			20416.27	31074.99
Branch Store	732.87		113.55		846.42						846.42	
Office Supplies	320.50			126.90	193.60						193.60	
Freight	125.60			87.15	38.45						38.45	
Warehouse Supplies	151.85			64.66	87.19						87.19	
Prepaid Insurance	261.80			52.30	209.50						209.50	
Prepaid Rent on Notes Pay			45.67			45.67						45.67
G. C. Hall	69.80				69.80						69.80	
E. A. Norman	72.35				72.35						72.35	
Office Equipment	665				665						665	
Exp for Office Equip		35.55		27.5		3830						3830
Warehouse Equipment												
Exp for Warehouse Equip		126.0		11.5		137.5						137.5
Delivery Equipment	1800				1800						1800	
Exp for Delivery Equip		680				751						751
Notes Payable		7110.65				7110.65						7110.65
Amount on Notes Payable				594		594						594
Accounts Payable		14047.74				14047.74						14047.74
Capital Stock		10000				10000						10000
Unissued Capital Stock	49400				49400							49400
Surplus		47152.4				47152.4						47152.4
Salaries	87.63				87.63		87.63	1678.532				
Sales Taxes and Allowances												
Purchased	11012.47				11012.47		11012.47					
Freight In	817.85				817.85		817.85					
Purchased Returns & Allowances		5970				5970		5970				

Illustration 73, Work Sheet

Balance Sheet. As explained at the beginning of this chapter, the Balance Sheet provides the same information for the board of directors and the stockholders in a corporation as it does for the owner of a sole proprietorship or the partners in a partnership. The Balance Sheet below, which was prepared from the Balance Sheet columns of the Work Sheet on pages 304 and 305, contains detailed information concerning current assets, deferred charges, fixed assets, current liabilities and proprietorship of the Ault Grocery Co. on June 30,

AULT GROCERY COMPANY

"Exhibit A"

BALANCE SHEET, JUNE 30, 19 .

Assets			
Current Assets:			
City National Bank	12140.18		
Petty Cash	20.00		
Certificate of Deposit	5000.00		
Notes Receivable . . . (Schedule 1)	1944.30		
Accrued Interest on Notes Receivable	3.41		
Accounts Receivable . . (Schedule 2)	15370.84		
Less Reserve for Bad Debts.	128.93	15241.91	
Merchandise Inventory. (Schedule 3).	31974.09		
Branch Store (Schedule 4).	8458.72		
Total Current Assets			74782.61
Deferred Charges:			
Office Supplies. . . . (Schedule 5).	198.60		
Postage.	38.45		
Warehouse Supplies . . (Schedule 6).	87.19		
Prepaid Insurance. . . (Schedule 7).	209.50		
Prepaid Interest on Notes Payable.	45.67		
J. C. Bell	69.80		
C. A. Norman	72.35		
Total Deferred Charges			721.56
Fixed Assets:			
Office Equipment . . . (Schedule 8).	665.00		
Less Depreciation Reserve	38.30	626.70	
Warehouse Equipment. . (Schedule 9).	275.00		
Less Depreciation Reserve	13.75	261.25	
Delivery Equipment . . (Schedule 10).	4800.00		
Less Depreciation Reserve	780.00	4020.00	
Total Fixed Assets			4907.95
Total Assets.			80412.12
Liabilities and Proprietorship			
Liabilities:			
Notes Payable. . . . (Schedule 11).	7110.65		
Accrued Interest on Notes Payable.	5.94		
Accounts Payable . . . (Schedule 12).	14047.74		
Total Liabilities			21164.33
Proprietorship:			
Capital Stock Authorized	100000.00		
Capital Stock Unissued	49400.00		
Capital Stock Outstanding.	50600.00		
Surplus.	8647.79		
Total Proprietorship.			59247.79

Illustration 74, Balance Sheet

AULT GROCERY COMPANY

"Exhibit B"

PROFIT AND LOSS STATEMENT FOR MONTH ENDING JUNE 30, 19 .

Merchandise Sales:			
Gross Sales	16785.32		
Less Sales Returns and Allowances	87.63		
Net Sales		16697.69	
Cost of Merchandise Sold:			
Merchandise Inventory, June 1.	29416.27		
Purchases 11012.47			
Less Returns and Allowances 59.70			
Net Purchases	10952.77		
Freight In 817.85			
Total Cost of Merchandise Available for Sale	41186.89		
Less Inventory, June 30	31974.09		
Cost of Merchandise Sold		9212.80	
Gross Profit on Sales		7484.89	
Operating Expense:			
Selling Expenses:			
Sales Salaries	965.83		
Traveling Expense	867.35		
Warehouse Salaries	216.67		
Warehouse Supplies Used	64.66		
Depreciation on Warehouse Equipment	1.15		
Miscellaneous Selling Expense	103.75		
Drivers Wages	249.17		
Depreciation on Delivery Equipment	100.00		
Expired Insurance on Delivery Equip.	11.75		
Miscellaneous Delivery Expense	6.75		
Total Selling Expenses	2587.08		
General Expenses:			
Rent	450.00		
Officers Salaries	650.00		
Office Salaries	550.33		
Office Supplies Used	126.90		
Postage Used	87.15		
Depreciation on Office Equipment	2.75		
Expired Insurance	40.55		
Loss on Bad Debts	16.79		
Miscellaneous General Expense	86.75		
Total General Expenses	2011.22		
Total Operating Expense		4598.30	
Net Profit from Operations		2886.59	
Other Income:			
Profit on Operation of Branch Store	1132.85		
Purchases Discount	299.88		
Interest Income	35.52		
Total Other Income		1468.25	
Gross Income		4354.84	
Deductions from Income:			
Sales Discount	192.86		
Interest Expense	29.43		
Donations	200.00		
Total Deductions from Income		422.29	
Net Profit		3932.55	

Illustration 75, Profit and Loss Statement

the close of the fiscal period. The information in this Balance Sheet will be of valuable assistance to the board of directors in controlling future operations of the corporation and will provide the individual stockholder with information for ascertaining the book value of the stock he owns.

The various schedules mentioned in connection with the current, fixed and deferred assets are not illustrated but should accompany the Balance Sheet for the information of the board of directors.

Profit and Loss Statement. As explained at the beginning of this chapter, the Profit and Loss Statement of a corporation provides the same information for the board of directors that the same type of statement furnishes for the owner of a sole proprietorship or the partners in a partnership. The Profit and Loss Statement on page 307, which was prepared from the Trading and Profit and Loss Statement columns of the Work Sheet on pages 304 and 305, contains detailed information regarding the income and operating expenses for the monthly fiscal period of June.

The Profit and Loss Statement as well as the Balance Sheet will be of assistance to the board of directors in controlling future operations of the corporation. The individual stockholder will not need the information on the Profit and Loss Statement for ascertaining his interest in the corporate proprietorship though he may be provided with a copy so that he may know the reason for the increase or decrease in the value of his stock.

REPORT

Complete Report No. 71 in the work book and present to the instructor for approval. Continue with the text discussion until Report No. 72 is required on page 312.

Adjusting Entries. The entries on the following page are those necessary to record in the general journal the adjustments shown in the Adjustments columns of the Work Sheet, pages 304 and 305. When these entries are posted, the account balances in the ledger will be the same as they appear in the Adjusted Trial Balance columns of the Work Sheet.

Closing Entries. The journal entries on pages 310 and 311 are those necessary to close the ledger of the Ault Grocery Co. These entries are made in two sections, (a) to close the trading account balances in the Trading columns, and (b) to close the expense and income account balances in the Profit and Loss Statement columns. As explained in Chapter XI, the trading accounts may be closed into a Trading account and the balance of this account closed into the Profit and Loss Summary account or all the account balances may be summarized in the one Trading, Profit and Loss Summary account.

The first entry at the top of page 310 is to close the trading accounts with a debit balance as recorded in the debit Trading column. The second entry on this page is to record the merchandise inventory June 30 and to close the trading accounts with a credit balance.

(Continued on page 311)

June 30, 19-

PAGE 19

5	Accrued Interest on Notes Receivable	341	
55	Interest Income		341
	To record accrued interest income.		
	30		
51	Loss on Bad Debts	1679	
7	Reserve for Bad Debts		1679
	To record the reserve for bad debts.		
	30		
9	Branch Store	113285	
53	Profit on Operation of Branch Store		113285
	To record profit on operation of branch store.		
	30		
47	Office Supplies Used	12690	
48	Postage Used	8715	
37	Warehouse Supplies Used	6466	
10	Office Supplies		12690
11	Postage		8715
12	Warehouse Supplies		6466
	To record supplies and postage used.		
	30		
44	Expired Insurance on Delivery Equipment	1175	
50	Expired Insurance	4055	
13	Prepaid Insurance		5230
	To record expired insurance		
	30		
14	Prepaid Interest on Notes Payable	4567	
57	Interest Expense		4567
	To record prepaid interest expense		
	30		
49	Depreciation on Office Equipment	275	
38	Depreciation on Warehouse Equipment	115	
41	Depreciation on Delivery Equipment	100 -	
18	Depreciation Reserve for Office Equip.		275
20	Depreciation Reserve for Warehouse Equip.		115
22	Depreciation Reserve for Delivery Equip.		100 -
	To record estimated depreciation		
	30		
57	Interest Expense	594	
24	Accrued Interest on Notes Payable		594
	To record accrued interest expense		

Illustration 76, Adjusting Entries

June 30, 19

PAGE 9

59	Trading Profit and Loss Summary	4133422	
5	Merchandise Inventory		2941627
31	Purchases		1101247
32	Freight In		81785
30	Sales Returns and Allowances		8763
	To close the trading accounts with a debit balance		
	30		
8	Merchandise Inventory	3197409	
29	Sales	65532	
33	Purchases Returns and Allowances	5970	
59	Trading Profit and Loss Summary		4881911
	To close the trading accounts with a credit balance		
	30		
59	Trading Profit and Loss Summary	258708	
34	Sales Salaries		26583
35	Traveling Expense		56735
36	Warehouse Salaries		21667
37	Warehouse Supplies Used		2466
38	Depreciation on Warehouse Equipment		115
39	Miscellaneous Selling Expense		18375
40	Express Wages		24917
41	Depreciation on Delivery Equipment		180
42	Expired Insurance on Delivery Equipment		1175
43	Miscellaneous General Expense		675
	To close the selling expense accounts		
	30		
59	Trading Profit and Loss Summary	201122	
44	Profit		450
45	Office Salaries		650
46	Office Supplies		55033
47	Office Supplies Used		12690
48	Postage Used		8715
49	Depreciation on Office Equipment		275
50	Expired Insurance		4055
51	Loss on Bad Debts		1679
52	Miscellaneous General Expense		8675
	To close the general expense accounts		

Illustration 77, Closing Entries

June 30, 19-

PAGE 21

53	Profit on Operation of Branch Store	1 32 51	
54	Trading Profit and Loss Summary To close the Profit on Operation of Branch Store account		1 32 55
	30		
54	Purchased Discount	2 04 88	
55	Interest Income	2 65 2	
59	Trading Profit and Loss Summary To close the Purchased Discount and Interest Income accounts		2 35 40
	30		
59	Trading Profit and Loss Summary	4 22 29	
56	Sales Discount		1 92 82
57	Interest Expense		29 43
58	Donations		2 00 -
	To close the Sales Discount, Interest Expense and Donations accounts		
	30		
59	Trading Profit and Loss Summary	3 932 55	
28	Surplus To close the Trading Profit and Loss Summary account		3 932 55

Illustration 77, Closing Entries, Concluded

The third and fourth entries on page 310 and the first three entries above are those necessary to close the accounts in the Profit and Loss Statement columns. These entries are made to close (a) the selling expense accounts, (b) the general expense accounts, (c) the Profit on Operation of Branch Store account, (d) the non-operating income accounts, and (e) the non-operating expense accounts.

Entry to Close the Profit and Loss Summary Account. The last entry above is made to close the Profit and Loss Summary account into the Surplus account. This is the only entry in closing the ledger of a corporation which differs from the closing entries for a sole proprietorship or partnership.

Classified Profit and Loss Summary Account. It is customary when posting the closing entries to show in separate sections of the Profit and Loss Summary account (a) gross profit on sales, (b) net profit on sales, and (c) the net profit for the period.

Illustration 78, page 312, shows the result of posting the closing entries in Illustration 77 and arranging the desired information in sections of the Profit and Loss Summary account.

Trading Profit and Loss Summary

PAGE 50

June 30	Wages Inv. 4/30	31974.09	June 30	Wages Inv. 4/30	31974.09
30	Purchases	110124.7	30	Sales	167853.2
30	Freight In	57.5	30	Net Profit on Sales	5970
30	Freight Out (Inv.)	57.5			
30	Gross Profit on Sales	110124.7			
		110124.7			110124.7
June 30	Salaries	965.53	June 30	Gross Profit on Sales	74845.9
30	Traveling Exp.	567.25			
30	Merchandise Sold	216.1			
30	Shop Used	64.66			
30	Dep on Shop Equip.	1.15			
30	Misc. Selling Exp.	113.72			
30	Freight In	249.1			
30	Dep on D. Equip.	1.66			
30	Exp. Ins on D. Eq.	11.75			
30	Trans. Del. Exp.	67.5			
30	Net Profit on Sales	4897.51			
		74845.9			74845.9
June 30	Rent	450.00	June 30	Net Profit on Sales	4897.51
30	Officers Salaries	650.00	30	Profit and O.B.S.	1132.55
30	Officers Salaries	550.33	30	Net Asset	299.88
30	Officership Used	120.41	30	Net Income	355.2
30	Trans. Del. Exp.	57.15			
30	Dep on Equip.	7.70			
30	Exp. Insurance	40.55			
30	Loss on Ind. Assets	16.79			
30	Misc. Admin. Exp.	56.00			
30	Sal. Disct.	172.50			
30	Int. Expense	27.00			
30	Donations	200.00			
30	Dep. Plan	27.22			
		6366.06			6366.06

Illustration 78, Trading, Profit and Loss Summary Account

REPORT

Complete Report No. 72 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 73 is required on page 322.

CHAPTER XXVI

COLUMNAR RECORDS

The purpose of columnar records is to facilitate posting and to provide for control of subsidiary ledgers. The need for columnar records is discussed and illustrated in previous chapters. The discussion in this chapter relates to (a) the cash journal, (b) the notes receivable and notes payable registers as columnar journals, and (c) columnar purchases and sales journals.

Cash Journal. A combination of the cash book and the general journal is referred to as a *cash journal*. This combination facilitates recording transactions and posting. The cash journal is of special value when many transactions of the same nature are to be recorded and one bookkeeper records them.

In a non-trading business the cash journal may be the only book of original entry required. In a trading business special journals will be required for recording purchases and sales. When transactions involving notes receivable and notes payable occur frequently, the note registers may be used as books of original entry.

The combined cash receipts journal and cash payments journal is sometimes referred to as a cash journal instead of a cash book. The usual interpretation of the cash journal, however, is a combination of two or more journals each of which has special columns for amounts to be posted in total to the same accounts.

Illustrations. The cash journal and the other journals usually required in connection with a trading business are best explained through illustrations. The illustrations (Nos. 79–84) which follow contain a record of the transactions completed by the Ault Grocery Company, a corporation, during the monthly fiscal period of June; the same records could have been used had the business been operated as a sole proprietorship or partnership.

The Ault Grocery Company sells groceries at wholesale and operates a branch store, in the same city, which serves the retail trade. All purchases are recorded in the purchases journal; sales to the branch store and to the wholesale trade are recorded in the sales journal; notes received from charge customers, in the notes receivable journal; notes issued to creditors and the bank, in the notes payable journal; and all other transactions in the cash journal.

Two subsidiary ledgers are maintained, one with accounts receivable and the other with accounts payable. Controlling accounts are maintained in the general ledger for each of these subsidiary ledgers. The transactions completed by the branch store are recorded by an accountant at the branch store. The Branch Store account in the general ledger contains a record of the assets transferred to the branch store and received from it. The balance of this account together with the reports prepared by the branch store accountant provide a control of the branch store records.

CASH JOURNAL FOR MONTH OF JUNE, 19

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CASH JOURNAL

[Ch. 26

CITY NATIONAL BANK		DATE	L F	NAME OF ACCOUNT	CHECK NO.	GENERAL LEDGER		ACCOUNTS REC. LEDGER		SALES DISCOUNT CR.	PURCHASES DISCOUNT CR.
DR.	CR.					DR.	CR.	DR.	CR.		
40854		1		✓ <i>Balance in Bank</i>							
		1		✓ <i>Miller & Ladd</i>					42118	1264	
	26667	1		✓ <i>Branch Store</i>	575						
		2		✓ <i>Leahy Bros.</i>							
25960		2		✓ <i>Notes Receivable</i>	576		2350				
	2350	2	10	✓ <i>Office Supplies</i>	577		203 -				
	30450	2	24	✓ <i>Shoemakers</i>							
		2		✓ <i>Branch Store</i>							
66814	70385	2		✓ <i>Wilson Paper Co.</i>	578		122050		42118		436
	130052										436
	438	4		✓ <i>Parker Bros. & Co.</i>	579		438				
56932		4		✓ <i>Williams Bros.</i>					58699	1761	
	450 -	4	44	✓ <i>Rent</i>	580						
1960 -		29		✓ <i>Notes Payable</i>							
		29	32	✓ <i>Freight Exp.</i>							
		29		✓ <i>Simon & Co.</i>							
	38919	30	57	✓ <i>Interest Expense</i>	610		100				
	132950	30	45	✓ <i>Office Supplies</i>	611						
	50 -	30	35	✓ <i>Traveling Expense</i>			50 -				
96250		30		✓ <i>Branch Store</i>							
	1936	30	39	✓ <i>Miscellaneous Living Expense</i>	612						
		30	43	✓ <i>Miscellaneous Living Expense</i>							
1959258	425821							18123	56143	14717	72058

Illustration 79. Cash Journal (Left Page)

CASH JOURNAL FOR MONTH OF JUNE, 19

PAGE 39

ACCOUNTS PAY LEDGER		NOTES RECEIVABLE CR.	NOTES PAYABLE DR.	BRANCH STORE		SALES RETURNS DR.	PURCHASES RETURNS CR.	SALES SALARIES DR.	OFFICE SALARIES DR.	DRIVERS WAGES DR.	WAREHOUSE SALARIES DR.	MISC GEN'L EXPENSE DR.	EXPLANATION
DR.	CR.			DR.	CR.								
2750		25966		2667			2721						Sale 5/2, less 3%
													June rent
													Misc. sold by us
													Note No 101
								2333	4233	1917	1667		Cash purchase
													Weekly pay roll
					1566	1566							Allow for shortage
72186		25966		2667	1566	1566	365	2333	4233	1917	1667		June 5, less 2% and balance
44936													To paid freight
													Sale 4/1, less 3%
													June sent
													Note No 88 at 5%
													Prepaid freight by
													J. Simon & Co
													Note No 89
								4445	127	5750	50		Weekly and monthly pay roll
													Expenses funds
													Weekly sales
													Issued checks
													June petty cash fund
321953	3116	261850	183325	84867	589497	8763	5970	46583	55033	24917	21667	8675	
23	23	23	23	23	23	23	23	23	23	23	23	23	

Illustration 79, Cash Journal (Right Page)

Recording Transactions in the Cash Journal. Each transaction which would be recorded in the separate cash book or the separate general journal is recorded in the cash journal. Before recording a transaction it is necessary to determine its effect on the assets, liabilities and proprietorship. When this effect has been determined, the transaction is recorded in the appropriate columns.

A minimum of two money columns and one line is required to record each transaction. The usual journal explanation is written in the column at the extreme right on the line or lines on which the transaction is recorded. The information in the Explanation column should provide a basis for an audit of the transaction. One criticism of the cash journal is the difficulty in auditing the transactions recorded therein; only through a complete explanation of each transaction can this criticism be overcome.

The cash balance entered on the first horizontal line is not placed in an amount column because it is already recorded in the account with the City National Bank in the general ledger. The cash balance at the beginning of the month is needed when proving cash during the month, hence it should be written in the cash journal.

Entries in Illustration 79. The first transaction is recorded on the second horizontal line. The statement in the Explanation column, "Sale of 5 22, less 3%" indicates that it is a collection from a charge customer less discount. To record a transaction of this nature, it is necessary to enter the amount of cash received in the column provided for cash receipts (City National Bank, Dr.), the decrease in the asset accounts receivable, in the column for Accounts Receivable Ledger, Cr. and the decrease in proprietorship, in the column for Sales Discount, Dr. The name of the charge customer is written in the Name of Account column. From the information in the three amount columns, the name of the account column, the explanation column and the date column, the transaction may be interpreted as "June 1, received check from Miller & Ladd for \$408.54 for sale of May 22, \$421.18, less 3% discount, \$12.64."

The nature of each transaction shown recorded in the illustration may be determined in the same manner as the interpretation of the first entry in the preceding paragraph. Thus, the second entry records payment of rent of the branch store; the third, a return of merchandise to a creditor; the fourth, collection of a note; the fifth, a purchase of office supplies for cash; the sixth, payment of the weekly pay roll, part of which was recorded as an accrued liability at the close of the May fiscal period.

Cash Proof. All cash received is deposited in the bank and all cash payments except small amounts are made by check; small amounts are paid from the petty cash fund. The title of the Cash account is the name of the bank. Each amount of cash received is recorded in the City National Bank, Dr. column and each amount paid, in the City National Bank, Cr. column.

When it is desired to prove cash, all amount columns are footed. The total of the cash receipts as recorded in the Bank, Dr. column plus the balance

on hand at the beginning of the month less the total payments recorded in the Bank, Cr. column should be the cash in the bank or the sum of the cash on hand and in the bank. At the time cash is proved, the equality of the debits and credits recorded in the various columns should also be proved. The total of the debit columns should equal the total of the credit columns.

The small figures in the illustrations on pages 314 and 315 show that cash was proved June 2. The total receipts, \$668.14 + \$8,865.81, balance June 1, = \$9,533.95; \$9,533.95 - \$1,300.52, total payments, = \$8,233.43, the cash on hand. The sum of all columns in which debit amounts are recorded is \$2,042.41. The total of the credit columns should be the same as the total of the debit columns.

Posting the Cash Journal. The amounts to be posted daily are those recorded in the General Ledger, Accounts Receivable Ledger, and Accounts Payable Ledger columns. Each amount entered in the General Ledger columns is posted to the debit or credit of an account in that ledger. Each amount entered in the Accounts Receivable Ledger columns is posted to the debit or credit of an account with the customer in that ledger. Each amount entered in the Accounts Payable Ledger columns is posted to the debit or credit of an account with the creditor in that ledger.

At the end of each month or when a Trial Balance is to be taken, cash is proved, the equality of debits and credits recorded in the various columns is proved, and the cash journal is ruled as in the illustration. The total of each column (except the General Ledger columns) is posted to the account in the general ledger written at the top of the column. The posting of the totals is indicated as shown in the illustration.

Columnar Purchases Journal. The illustration on page 318 contains a record of the purchases during June; the waved lines indicate an omission of a part of the record. Three amount columns are provided because merchandise is purchased for the main store and the branch store. Each purchase invoice is analyzed to determine the amount to be entered in each of the three columns. The total of the invoice is entered in the Accounts Payable, Cr. column, the branch store purchases in the Branch Store, Dr. column, and the main store purchases in the Purchases, Dr. column.

Posting the Purchases Journal. Each amount entered in the Accounts Payable, Cr. column is posted to the credit of the account in the accounts payable ledger written on the same line with it; this posting is daily. At the end of the month, the three columns are footed, proved to be correct, and ruled as in the illustration. The posting of the totals is indicated as in the illustration.

Columnar Sales Journal. The illustration on page 318 contains a record of the sales during June; the waved line indicates an omission of a part of the records. Each sales invoice is analyzed to determine the amount to be entered in each column. The amount of a sale to a charge customer is entered in the Accounts Receivable, Dr. column, a sale to the branch store in the Branch Store, Dr. column, and the total of the invoice in the Sales, Cr. column.

PURCHASES JOURNAL

PAGE 10

June 19-

DATE	L F	ACCOUNT CREDITED	ADDRESS	TERMS	INV. DATE	ACCOUNTS PAYABLE CR	BRANCH STORE DR	PURCHASES DR
3	✓	Anderson Bros	Philadelphia	30 days	3	44457	221 60	75327
9	✓	Nelson Paper Co	City	30 days	10	55493	219 65	53978
11	✓	Lea Brothers & Co	Wilmington	30 days	11	40517		40517
13	✓	P. H. Haynes & Co.	Winston	30 days	13	46575	135 15	32770
14	✓	Church and Smith &	New York	30 days	14	48912		48912
30	✓	Riley & Hubbs	Cincinnati	30 days	30	40505	48 15	49940
30	✓	Longman & Co	New York	30 days	30	213574		213574
30	✓	National Trust Co	Chicago	30 days	30	11732	151 25	54697
30	✓	Boston & Carson	Nashville	30 days	30	24365		24365
30	25	Branch Store, Dr						
30	9	Branch Store, Dr						
30	31	Branch Store, Dr						
		<i>running</i>	<i>memo</i>					

Illustration 80, Purchases Journal

Posting the Sales Journal. Each amount entered in the Accounts Receivable, Dr. column is posted to the debit of the account in the accounts receivable ledger written on the same line with it; this posting is daily. At the end of the month, the three columns are footed, proved to be correct and ruled as in the illustration. The posting of the totals is indicated as in the illustration.

SALES JOURNAL

PAGE 20

June 19-

DATE	L F	ACCOUNT DEBITED	ADDRESS	TERMS	SALE NO.	ACCOUNTS RECEIVABLE DR.	BRANCH STORE DR	SALES CR
1	✓	Williams Bros	Philadelphia	30 days	12	55223		58493
2	✓	Johnston Bros & Co	New York City	30 days	528	61645		61645
2	MP	Branch Store			124		10557	105570
4	✓	Kindel Smith	Wilmington	30 days	130	6129		6129
4	✓	Wing & Nelson Co	New York City	30 days	531	48367		48367
6	✓	Carr & Barber	Wilmington	30 days	532	23156		23156
6	✓	Anderson & Lane	Philadelphia	30 days	533	35991		35991
20	✓	C. K. Bobbitt & Co	Philadelphia City	30 days	555	54521		54521
20	MP	Branch Store			556		78492	78492
20	✓	Saylor & Day	Springfield	30 days	557	108068		108068
30	6	Branch Store, Dr						
30	9	Branch Store, Dr						
30	24	Sales, Cr						

Illustration 81, Sales Journal

The illustration below shows a ledger account when a posting machine is used. The first entry in the sales journal, Illustration 81, and the entry of June 4 in the cash journal, Illustration 79 have been posted to this account.

NAME WILLIAMS BROS.						
ADDRESS 319 MARKET ST. PHILADELPHIA						
BALANCE	DATE	FOLIO	MEMO.	REMARKS	CHARGES	CREDITS
586 93 TS	JUN 1 29		\$20	3/10 - N/30	586 93	
00 TS	JUN 4 29		019			586 93

Columnar Notes Receivable Journal. If the transactions with notes receivable are numerous, the notes receivable register may be used as a book of original entry in which case it is known as a *notes receivable journal*. The use of the notes receivable journal avoids the necessity of recording each note receivable in the general journal thus providing in one book (a) detailed information regarding all the notes receivable and (b) a means of posting.

The illustrations on pages 320 and 321 contain a record of the notes and acceptances receivable received by the Ault Grocery Company during the months of May and June. Five amount columns are provided, (a) face of the note, (b) accounts receivable ledger, (c) interest income (two columns), and (d) general ledger. The face of a note received from a charge customer is entered in the Notes Receivable, Dr. and Accounts Receivable, Cr. columns if the customer receives credit for the face; if interest is involved, the proceeds are entered in the Accounts Receivable column and the interest in the appropriate Interest Income column. The face of a note which is to be credited to an account in the general ledger is entered in the Notes Receivable, Dr. and General Ledger, Cr. columns. Thus, note No. 101 was received from K. V. Otto to renew another note, hence Notes Receivable in the general ledger is credited. Note No. 102 was received from W. H. Bowser, a charge customer, in settlement of his account, hence an account in the accounts receivable ledger is credited.

Posting the Notes Receivable Journal. Each amount entered in the Accounts Receivable, Cr. column is posted to the credit of the account with the charge customer in the accounts receivable ledger written on the same line with it; this posting is daily. Each amount entered in the General Ledger, Cr. column is posted to the credit of the account in the general ledger written on the same line with it; this posting is daily. At the end of the month, each

NOTES RECEIVABLE JOURNAL									
PAGE 3									
DATE	OUR NO.	L F	FROM WHOM RECEIVED ACCOUNT CREDITED	FACE OF PAPER		INTEREST INCOME		ACCOUNTS REC. DR.	GENERAL LEDGER F.D.
				DR.	CR.	DR.	CR.		
Jan 3	101	✓	Notes Receivable	2500				2500	K. V. Otto
" 10	102	✓	H. H. Bower	5500				5500	H. H. Bower
" 20	103	✓	Gordon & Kane	4000				4000	Gordon & Kane
" 25	104	✓	Saylor & Day	4000				4000	Saylor & Day
				2500				2500	
Feb 1	105	✓	Miller + Ladd	5000				5000	Miller + Ladd
" 2	106	✓	Miller + Ladd	5000				5000	Miller + Ladd
" 10	107	✓	Miller + Ladd	5000				5000	Miller + Ladd
" 15	108	✓	Miller + Ladd	5000				5000	Miller + Ladd
" 23	109	✓	Miller + Ladd	5000				5000	Miller + Ladd
				2500				2500	

Illustration 82, Notes Receivable Journal (Left Page)

NOTES PAYABLE JOURNAL									
PAGE 3									
DATE	OUR NO.	L F	IN WHOSE FAVOR ACCOUNT DEBITED	FACE OF PAPER		INTEREST EXPENSE		ACCOUNTS PAY. DR.	GENERAL LEDGER DR.
				DR.	CR.	DR.	CR.		
Apr 12	75	✓	Notes Payable	2500				2500	Notes Payable
" 28	76	✓	Notes Payable	3200				3200	Notes Payable
" 29	77	✓	Notes Payable	2000				2000	Notes Payable
				2500				2500	
May 1	78	✓	Notes Payable	5000				5000	Notes Payable
" 9	79	✓	Notes Payable	3500				3500	Notes Payable
" 16	80	✓	Notes Payable	41127				41127	Notes Payable
" 22	81	✓	Notes Payable	73685				73685	Notes Payable
" 25	82	✓	Notes Payable	3200				3200	Notes Payable
" 27	83	✓	Notes Payable	38725				38725	Notes Payable
				2500				2500	
June 5	84	✓	Notes Payable	2700				2700	Notes Payable
" 11	85	✓	Notes Payable	4000				4000	Notes Payable
" 15	86	✓	Notes Payable	750				750	Notes Payable
" 22	87	✓	Notes Payable	4500				4500	Notes Payable
" 27	88	✓	Notes Payable	2000				2000	Notes Payable
				2500				2500	

Illustration 83, Notes Payable Journal (Left Page)

column is footed, the addition proved to be correct and the totals (except General Ledger column) posted to the account in the general ledger written at the top of each column.

Columnar Notes Payable Journal. When the transactions with notes payable are numerous, the notes payable register may be used as a book of original entry in which case it is known as a *notes payable journal*. This plan avoids the necessity of recording each note payable in the general journal as explained in connection with the notes receivable journal.

The notes payable journal, Illustration 83, contains a record of the notes and acceptances issued by the Ault Grocery Company during the months of

NOTES RECEIVABLE JOURNAL

PAGE 5

DATE OF PAPER			TIME TO RUN	RATE OF INT.	WHEN DUE												WHERE PAYABLE		REMARKS	
YEAR	MONTH	DAY			YEAR	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC			
19	March	3	31 days	-	6													N. O. National Bank	Paid June 2	
12	March	17	"	-	14							16						First Nat. Bank		
10	March	30	"	-	3													Union Nat. Bank	Bank for call 4/20	
19	March	31	60	6%	19													Springfield Trust Co.	Paid June 29	
19	June	1	30	"	-	0												Third Office	Paid June 28	
19	June	2	"	6%	1													State Nat. Bank	Paid June 28	
19	June	7	"	-	2													City Nat. Bank	Paid June 27	
19	June	15	"	-	17													First Nat. Bank		
19	June	25	"	-	17													Friedrich Sons & Co.		

Illustration 82, Notes Receivable Journal (Right Page)

NOTES PAYABLE JOURNAL

PAGE 3

DATE OF PAPER			TIME TO RUN	RATE OF INT.	WHEN DUE												WHERE PAYABLE	REMARKS	
YEAR	MONTH	DAY			YEAR	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV	DEC.		
19	April	12	30	"	-													City Nat. Bank	1st amt paid on advances
19	April	28	30	"	-	19				28								" " "	Paid May 27
19	April	29	30	"	-	19				29								" " "	Paid May 29
19	May	1	30	"	-	19				31								City Nat. Bank	Paid May 31
19	May	3	30	"	-	19					2							" " "	Paid June 4
19	May	16	15	"	-	19				31								" " "	Paid May 31
19	May	22	30	"	-	19					21							" " "	Paid June 22
19	May	25	30	"	-	19					24							" " "	Paid June 24
19	May	31	30	"	6%	19					30							" " "	Paid June 30
19	June	5	60	"	6%	19								11				City Nat. Bank	
19	June	11	30	"	-	19						11						" " "	Paid July 11
19	June	15	60	"	6%	19								14				" " "	
19	June	22	30	"	-	19						22						" " "	
19	June	29	90	"	-	19									27			" " "	2nd amt paid on advances

Illustration 83, Notes Payable Journal (Right Page)

April, May, and June. Five amount columns are provided for (a) face of the note, (b) accounts payable ledger, (c) interest expense (two columns) and (d) general ledger. When a note issued is to be debited to an account in the general ledger, the face is entered in the Notes Payable, Cr. and General Ledger, Dr. columns. When the note is issued to a creditor or a draft is accepted, the face is entered in the Notes Payable, Cr. and Accounts Payable, Dr. columns.

Posting the Notes Payable Journal. Each amount entered in the Accounts Payable, Dr. column is posted to the debit of the account with the creditor in the accounts payable ledger written on the same line with it; this

posting is daily. Each amount entered in the General Ledger, Dr. column is posted to the debit of the account in the general ledger written on the same line with it; this posting is daily. At the end of the month, each column is footed, the addition proved to be correct and the totals (except General Ledger column) posted to the account in the general ledger written at the top of each column.

Columnar Petty Cash Book. The petty cash fund provides a means of making small payments with currency. As explained in a preceding discussion, the purpose of the petty cash book is to provide a record of the payments from this fund. The petty cash book may contain only two columns, one for receipts to replenish the fund and the other for payments from the fund, or it may contain special columns. The purpose of special columns is to facilitate the recording of the total payments in the general cash book.

The illustration below shows the petty cash book with one amount column for receipts, three amount columns for three separate expense accounts and one amount column for expenditures of a general nature.

PETTY CASH BOOK									
DATE	EXPLANATION	RECEIPTS	PAYMENTS				SUNDRY ACCOUNTS		
			MISC. SELLING	DELIVERY	MISC. GEN.				
19 Oct	1 Check No 162	25 -							
	1 Telegrams					1 35			
	2 Messenger			60					
	3 Wages of extra sales clerk						Sales Salaries		4 50
	8 Entertainment of a customer		11 25						
	10 Notary fee					20			
	11 Messenger			1 25					
	16 Ad. in L. S. News		2 50						
	16 Special tele. copy stamps						Office Supplies		4 -
	17 Repairing tire								
		25 -	6 75	2 50	2 55				5 50
19 Nov	17 Balance	43 5							
	17 Check No 210	20 65							

Illustration 84, Petty Cash Book

REPORTS

Complete Reports Nos. 73 and 74 in the work book and present to the instructor for approval. The instructor will advise whether you are to complete Practice Set 4 at this time or continue with the text discussion until Report No. 75 is required on page 330.

CHAPTER XXVII

MANUFACTURING ACCOUNTS

The merchant buys merchandise and sells it in the same form in which it is purchased. The manufacturer buys raw material and through the operations of the factory, changes its form to meet the needs of his customers. The method of recording transactions to provide the merchant with the cost of merchandise purchased has been explained in preceding chapters. The discussion in this chapter relates to the method of recording transactions to provide the manufacturer with the cost of the merchandise manufactured.

Manufacturing. The manufacturer makes such things as clothing, food products, furniture, kitchen utensils and automobiles. In producing these articles, he must have a factory equipped with machinery, employees to operate the machinery, and the required raw materials. In other words, manufacturing involves three cost elements: the *raw materials* or *materials*; *labor cost*; and the general expense of operating the factory and machinery, known as *burden* or *manufacturing expense*.

Materials. The manufacturer of clothing must have cloth, thread, buttons, and various other articles needed in the completed garment. The manufacturer of automobiles requires steel, casting, wood, glass, leather, and the various other articles. The various types of commodities needed in the manufacture of a finished article are referred to as *materials* or *raw materials*.

Labor. No matter how well a factory may be equipped with automatic machinery, the human element is essential to the successful operation of the machinery. The amount paid employees to operate the machinery, do hand work or supervise machine operators or hand workers, is known as *labor cost*. The work of operators engaged in making the things manufactured is known as *direct labor* to distinguish it from the labor of those who supervise or do work not directly applicable to any one job which is designated as *indirect labor*.

Prime Cost. The materials and direct labor costs in the finished article are referred to as the *prime cost* of the article. If the leather and other material used in the manufacture of a pair of shoes costs \$3.35 and the labor cost is \$2.20, the prime cost is \$5.55.

Burden. The expenses incident to the operations of a factory and the manufacture of the products is referred to as either *overhead expense*, *manufacturing expense*, or *burden*. The principal items of burden are rent, repairs to machinery, depreciation on machinery, property taxes, insurance, heat, light, power and indirect labor.

Factory Cost. The factory cost of a finished article is the sum of the prime cost and the burden applicable to the article. Thus, materials cost+labor cost+burden=factory cost. If the burden applicable to the shoes mentioned in the preceding illustration is \$1.00, the factory cost is \$6.55; prime cost, \$5.55+burden, \$1.00=factory cost, \$6.55.

Manufacturing Process. A factory equipped with the required machinery and the needed employees to operate this machinery are essential to the manufacturing process. Since the manufacturer must know the factory cost before fixing the selling price, the manufacturing process is divided into *cost periods* usually one month in length. The materials, labor and burden cost during each cost period are recorded so that the cost of the goods manufactured during that period may be ascertained at its close.

Recording Material Cost. The required materials are purchased and debited to an account with the title *Materials*. The materials are usually kept in the storeroom and requisitioned as needed in the manufacturing process. When materials are requisitioned, an account with the title *Material in Process* is debited and the Materials account credited for the cost of the material requisitioned.

Recording Labor. Wages due employees on payday are paid with cash and debited to an account with the title *Labor*, or *Pay Roll*. Salaries of the superintendent and foreman and wages of those employees who do work of a general nature may be debited to an account with *Indirect Labor* at the time the pay roll is paid. When all labor cost is debited to the account with Labor, the amount of the indirect labor as shown by the pay roll is transferred from the Labor account to the Indirect Labor account at the close of the cost period.

Recording Burden. Expenditures for burden such as rent, power, heat, light and other expenses of a like character are debited to accounts with appropriate titles at the time the expenses are paid during the fiscal period. Other burden costs, such as depreciation, expired insurance, and property taxes are recorded in appropriate accounts at the close of the fiscal period; Depreciation on Factory Equipment, Expired Insurance on Factory Equipment, and Property Taxes on Factory Equipment are the usual expenses of this type. The balances of the various burden accounts are summarized in one account with Burden at the close of the fiscal period.

Materials in Process. At the close of the cost period, the balance of the Materials in Process account shows the cost of all materials placed in process during the period. The sum of the labor and burden costs for the period and the materials placed in process is the total cost of goods manufactured during the period provided all goods placed in process have been manufactured and assuming that no goods were in process at the beginning of the period. If all the goods placed in process have not been manufactured, it will be necessary to take an inventory of the incompleated goods in order to ascertain the cost of those completed.

Manufacturing Statement. At the close of each cost period, a Manufacturing Statement is prepared from the account balances which show the material, labor, and burden cost, and the inventory of incompletd jobs in process of manufacture. The facts shown on this statement include (a) the value of the work in process at the beginning of the cost period, (b) the materials, labor, and burden cost during the period, (c) the value of the work in process at the close of the cost period, and (d) the cost of the finished goods completed during the cost period.

Work in Process. When the Manufacturing Statement is completed, the materials, labor and burden costs are summarized in an account with the title Work in Process, through entries in the general journal. The Work in Process account is debited for the balances of the Materials in Process, Labor and Burden accounts and credited with the cost of the finished goods as shown by the Manufacturing Statement. The Finished Goods account is debited for the cost of the goods completed during the period.

Finished Goods. When the journal entries referred to in the preceding paragraph have been posted, the balance of the Finished Goods account will show the cost of finished goods available for sale. This balance corresponds to the sum of the beginning inventory and the balance of the Purchases account in a mercantile business. The needed information is usually shown on the Trading Statement in two amounts, (a) beginning inventory, and (b) cost of finished goods.

Illustrations of the Manufacturing Process. The accounts in the illustration at the right appear on the ledger of the Candy Kitchen, a corporation engaged in manufacturing candy, at the beginning of the monthly fiscal period, December 1. The balance of the Materials account shows the materials in the storeroom, December 1, to be requisitioned when needed. The balance of the Work in Process account shows the asset value of the material, labor and burden costs applicable to the candy in the course of manufacture, December 1. The balance of the Finished Goods account shows the inventory of candy ready for sale, December 1. Each of these accounts balances appeared as assets on the Balance Sheet, November 30. The first represents the cost value of material in stock; the second, the cost value of material, labor and burden in process of manufacture; and the third, the cost of the finished goods in stock.

MATERIALS									
19									
Dec.	1	Inven.	√	3450	30				
WORK IN PROCESS									
19									
Dec.	1	Inven.	√	3692	58				
FINISHED GOODS									
19									
Dec.	1	Inven.	√	10676	48				

The following transactions affecting factory cost were completed during the December cost period.

- 1. Paid December rent of the factory, \$325.00.
- 5. Paid premium on insurance for factory equipment for one year beginning December 1, \$180.00.
- 31. Paid monthly pay roll: indirect labor, \$550.00; direct labor, \$4,711.40.
- 31. Paid December electric power bill, \$498.90.
- 31. Total purchases of material during the December cost period as shown by the purchases journal, \$11,131.71.
- 31. Total value of material requisitioned for factory use as recorded in the requisition journal, \$9,831.42.
- 31. Expired insurance on factory equipment, \$15.00; accrued property taxes on factory equipment, \$29.90; and depreciation on factory equipment, \$58.70.
- 31. Inventory value of work in process which includes material, labor and burden costs, \$1,499.85.

The entries to record the cash payments are:

December, 19		CASH		Payments	
Date	L. F.	Name of Account	Explanation	Amount	
1	327	Rent	December rent	325 —	
5		Prepaid Insurance	On factory equipment	180 —	
31	327	Indirect Labor	Salaries of supt. and foremen	550 —	
31	327	Labor	December direct labor cost	4711 40	
31	327	Power	December bill	498 90	

The entries in the general journal to record (a) total materials purchased,

December 31, 19					
327	Materials.....	11131	71		
	Accts. Payable.....			11131	71
	Total materials purchased.				
	31				
327	Materials in Process.....	9831	42		
327	Materials.....			9831	42
	To record material requisitioned.				
	31				
327	Expired Ins. on Fact. Equip. .	15	—		
327	Property Taxes.....	29	90		
327	Depreciation on Fact. Equip. .	58	70		
	Prepaid Insurance.....			15	—
	Accrued Property Taxes....			29	90
	Dep. Res. on Fact. Equip. .			58	70
	To record the accruals, deferred items and depreciation.				

(b) total materials requisitioned and (c) expired insurance, taxes and depreciation are shown in the illustration at the left. The total materials cost and the total cost of material requisitioned may be posted from the purchases and requisition journals, but the debits and credits are shown here in journal form for the sake of brevity.

The accounts at the right show the results of posting the entries affecting materials, material in process, labor and burden costs. The various items of burden are shown posted direct to the one Burden account with the title of the element in the explanation column, instead of being posted to the separate accounts and then summarized in the one Burden account. The final results are the same in either case. The Manufacturing Statement in the illustration below was prepared from the account balances in the ledger and the inventory of work in process December 31, \$1,499.85.

MATERIALS									
19 Dec.	1	Inven.	√	3450 30	19 Dec.	31	J 326	9831 42	
	31	4750.59	J 326	11131 71					
				14582 01					
MATERIALS IN PROCESS									
19 Dec.	31	J 326	9831 42						
LABOR									
19 Dec.	31	C 326	4711 40						
BURDEN									
19 Dec.	31	Ind. Labor	C 326	550	—				
	31	Rent	C 326	325	—				
	31	Power	C 326	498	90				
	31	Exp. Ins.	J 326	15	—				
	31	Prop. Taxes	J 326	29	90				
	31	Dep. on F. E.	J 326	58	70				
				1477	50				
WORK IN PROCESS									
19 Dec.	1	Inven.	√	3692 58					
CANDY KITCHEN									

CANDY KITCHEN

MANUFACTURING STATEMENT FOR MONTH OF DECEMBER, 19

Raw Materials				
Inventory December 1	3450	30		
Purchases during December	11131	71	14582	01
Less Inventory December 31.			4750	59
Cost of Materials Placed in Process.			9831	42
Labor			4711	40
Burden				
Indirect Labor	550	00		
Rent	325	00		
Power.	498	90		
Expired Insurance.	15	00		
Property Taxes	29	90		
Depreciation on Factory Equipment.	58	70	1477	50
Total Cost of Work Placed in Process.			16020	32
Add Work in Process December 1.			3692	58
Cost of Work to be Accounted for.			19712	90
Less Work in Process December 31.			1499	85
Cost of Finished Goods			18213	05

Illustration 85, Manufacturing Statement

The first entry in the illustration at the right is to summarize the balances of the Materials in Process, Labor and burden accounts in the Work in Process account. The second entry is to record the cost of the candy manufactured during December. The cost of the candy finished during the December cost period is debited to an account with the title Finished Goods; this account has the same meaning to the manufacturer as the sum of the balances of the Merchandise inventory and Purchases accounts has to the merchant.

December 31, 19			
328	Work in Process	16020 32	
	Materials in Process		9831 42
	Labor		4711 40
	Indirect Labor		550 —
	Rent		325 —
	Power		498 90
	Expired Insurance		15 —
	Property Taxes		29 90
	Dep. on Fact. Equip.		58 70
	To summarize the Materials in Process, Labor and Burden accounts in the Work in Process account.		
	31		
328	Finished Goods	18213 05	
328	Work in Process		18213 05
	To record the cost of candy manufactured during December.		

The accounts in the illustration at the left show the open manufacturing accounts after the above journal entries are posted to the ledger illustrated on page 327. The balance of the Materials account shows the asset value of the material in the store room and the balance of the Work in Process account the asset value of materials, labor and burden in process of manufacture. The accounts which show the cost of materials placed in process, labor and the burden during the cost period are in balance and are not

MATERIALS					
19	Dec.	1	Inv.	√	3450 30
		31	J 326		11131 71
					14750 59
					14582 01
19	Dec.	31			J 326 9831 42
WORK IN PROCESS					
19	Dec.	1	Inv.	√	3692 58
		31	J 328		16020 32
					1499 85
					19712 90
19	Dec.	31			J 328 18213 05
FINISHED GOODS					
19	Dec.	1	Inv.	√	10676 48
		31	J 328		18213 05
					28889 53

shown in the illustration. The Finished Goods account shows the value of the candy in stock December 1 plus the cost of the candy manufactured during December; the balance of this account now shows the "cost of merchandise available for sale."

The credit to the Finished Goods account because of the candy sold during December is not shown in the foregoing illustration. The purpose of these illustrations is to show the method of recording factory costs as they occur

during the cost period and of recording the cost of the goods finished during the period. The cost of sales for the manufacturer is the difference between the balance of the Finished Goods account and the inventory of finished goods in stock at the close of the cost period.

Unit Cost. The cost of each article manufactured, as an automobile, a pair of shoes, a pound of butter, a gallon of molasses, or a barrel of flour is known as the *unit cost*. When the factory produces only one kind of unit, the cost of each unit may be ascertained by dividing the total factory cost by the total number of units produced. Thus, if a manufacturer of flour produces one thousand barrels during a cost period, and the manufacturing cost for this period is \$7,000.00, the unit cost or the factory cost per barrel is \$7.00.

Cost Accounting. When the products of the factory are not all the same, it is necessary to provide a supplementary record which will show factory cost for each article or group of articles of the same kind and quality. The keeping of this supplementary record is known as cost accounting.

The Materials Account is a record of the increases and decreases in the asset materials. This account is *debited* for the cost of the goods when purchased or when returned to the storeroom by the factory, and *credited* for the cost of materials returned to the vendor or requisitioned for use in manufacturing. The *debit* balance of the Materials account is the asset value of the material still in the storeroom; this should be verified at the close of each cost period by a physical inventory.

The Materials in Process Account is a record of the materials requisitioned for factory use. This account is *debited* for the cost of materials requisitioned, and *credited* for the cost of materials returned by the factory to the storeroom. The *debit* balance of the Materials in Process account at the close of the cost period shows the materials placed in process during the cost period. It is shown on the Manufacturing Statement as one of the factory costs and closed into the Work in Process account.

The Labor Account is a record of the increases in direct labor cost. This account is *debited* for the amount paid for direct labor. The *debit* balance at the close of the cost period shows the direct labor cost for the period. It is shown on the Manufacturing Statement as a part of the factory cost and closed into the Work in Process account.

The Burden Accounts, that is, the accounts with the various elements of burden, contain a record of the increases in the burden costs. A separate burden account with an appropriate title is debited for increases because of factory expenses paid or accrued, factory supplies consumed, insurance expired, depreciation on factory buildings, etc.

The *debit* balance of each burden account shows the burden cost for one item and the sum of all these the total burden cost. Each element of burden is shown separately on the Manufacturing Statement as a part of the factory

cost. In the ledger these separate accounts are summarized in one Burden account, the balance of which is transferred to the Work in Process account.

The Work in Process Account is a summary of the material, direct labor and other factory costs for the cost period. This account is *debited* at the close of the cost period for the balance of the Materials in Process, Labor and Burden accounts, and *credited* with the cost of finished goods as shown by the Manufacturing Statement. The *debit* balance of this account shows the asset value of the goods still in process at the close of the cost period. It is verified by a physical inventory.

The Finished Goods Account contains a record of the factory products completed, and made available for sale. This account is *debited* for increases as shown by the Manufacturing Statement. The *debit* balance during the fiscal period shows the cost of finished goods on hand at the beginning of the period; at the close of the cost period this account is *debited* with the cost of work completed during the period and *credited* with the cost of the goods sold. The *debit* balance of this account shows the asset value of the finished goods on hand.

Work Sheet for Manufacturing Accounts. When preparing a Work Sheet for a business which maintains manufacturing accounts, it is customary to summarize the manufacturing account balances in a Manufacturing column in the same manner as the trading accounts are assembled in a Trading column. Since practically all businesses sell their products whether these products are bought or manufactured, the Work Sheet for a manufacturing business will require two more columns than for a mercantile business. The columns required are (1) Trial Balance, Dr. and Cr., (2) Adjustments, Dr. and Cr., (3) Adjusted Trial Balance, Dr. and Cr., (4) Manufacturing, Dr. and Cr., (5) Trading, Dr. and Cr., (6) Profit and Loss Statement, Expense and Income, and (7) Balance Sheet, Assets and Liabilities.

REPORT

Complete Report No. 75 in the work book and present for approval. Continue with the text discussion until Report No. 76 is required on page 334.

Voucher System of Accounting. The problems in connection with purchases for a manufacturing business are more complicated than those for a mercantile business. The manufacturer must buy raw material of various kinds, factory equipment, repairs, labor and other types of services which are not needed by the merchant. When the business is large, these purchases are completed by assistants, hence those in authority must provide some means of knowing that all cash payments are for authorized purchases. The desired control may be provided through the *voucher system of accounting*. This is not a system of accounting but rather a special phase of the accounting process which provides for control of expenditures.

Illustration 86, Inside of Voucher Jacket

An account is not maintained with each individual creditor when the voucher system is used; the Vouchers Payable account records all liabilities. This account is credited for all vouchers issued and debited for all vouchers paid. The amount due creditors is shown by the credit balance of the Vouchers Payable account.

DISTRIBUTION		RECAPITULATION	
Accounts Debited:		Voucher No. 1	
Raw Materials		Issued January 2, 19	
Direct Labor		To	Kauffman Bros.
Indirect Labor		Address	
Factory Supplies	22.50	Amount	\$ 41.25
Factory Expense		Recorded in V. P. Register on Page	1
Repairs		Terms	1/30 - n/60
Salaries		Disc	January 1, 19
Misc. Selling Expense		Paid	February 1, 19
Office Salaries		Check No.	361 For \$ 40.84
Misc. General Expense		Discount	\$ 4.41
SUNDRY ACCOUNTS		Certification	
Office Supplies 15.75		The Voucher has been carefully audited and is correct in every respect.	
Total (V. P. Cr.) 41.25		Auditor	
		(Made in U. S. A.)	

Illustration 86, Outside of Voucher Jacket

Two files are maintained for vouchers issued, (1) for those unpaid, and (2) for those paid. When cash is to be paid at the time the service is rendered, that is, purchases for cash, the voucher is issued, recorded and filed in the paid voucher file. When the purchase is made for credit, the voucher is issued and filed in the unpaid voucher file until it is paid and then placed in the paid file.

The Voucher Register is a journal which provides a means of posting vouchers issued. It differs from the purchases journal in that it contains a

VOUCHERS PAYABLE REGISTER									
DATE	VCH NO	IN FAVOR OF	PARTICULARS	PAYMENT		VOUCHERS PAYABLE CR	RAW MATER ALS DR	DIRECT LABOR DR	
				DATE	CHECK NO				
Jan 2	1	Kauffman Bros.	Inv Jan 2, 1/30-7/60			41.25			
2	2	Thompson Realty Co.	Factory rent	Jan 2	321	375 -			
2	3	The Day Machine Co.	Repairs	2	322	13.75			
4	4	H. S. Montross	Office rent	4	323	150 -			
8	5	Ray Roll	Week ending Jan 7	8	324	864.41			378.60
28	52	C. H. Duncan & Co.	Inv Jan 27 7/10-7/30			462.35	462.35		
29	53	Ray Roll	Week ending Jan 28			901.20			411.70
31	54	Roset Bros. & Co.	Inv Jan 30, 3/10-7/60			741.55	741.55		
						2107.02	1257.16	514.18	0
						35	10	38	

Illustration 87, Voucher Register (Left Page)

record of all purchases of material and service whether for cash or on credit. The vouchers are numbered consecutively and entered in the voucher register in the same order. The amount of each voucher is entered in the Vouchers Payable column, hence the total of this column at all times shows the total purchases of supplies and material. Columns are provided at the right of the Vouchers Payable column for the usual account titles debited because of purchases; the sum of the amounts entered in the columns at the right should equal the one amount in the Vouchers Payable column on the same line with it.

Illustration 87 on pages 332 and 333 shows the voucher register used by the Candy Kitchen during the month of January; the record shows only a part of the purchases, the waved line indicating an omission. Columns are provided for all the information shown on the voucher, also for the accounts credited and debited as stated on the back of the voucher. The one column at the extreme right is for miscellaneous accounts which are not affected with sufficient frequency to require a column.

Posting the Voucher Register. The voucher register contains a record of all purchases arranged so as to post the totals only at the end of the month; the only exception to this is the amounts entered in the Miscellaneous column at the extreme right which are posted daily. At the end of the month the total of the Vouchers Payable column is posted to the credit of the Vouchers Payable account in the general ledger and the total of each of the other columns except the last one, posted to the debit of the account written at the top of the column; as explained, the amounts in the Miscellaneous column are posted daily.

The Check Register is a journal provided for recording cash payments all of which are made by check. The ruling provides for recording full information in regard to each check issued and the accounts debited and credited. Since the Vouchers Payable account is credited for each voucher and checks are issued only for vouchers, the Vouchers Payable account must be debited

VOUCHERS PAYABLE REGISTER										
INDIRECT LABOR DR.	FACTORY SUPPLIES DR.	FACTORY EXPENSE DR.	REPAIRS DR.	SALES SALARIES DR.	MISC. SELL. EXPENSE DR.	OFFICE SALARIES DR.	MISC. GEN'L EXPENSE DR.	SUNDRY ACCOUNTS DR.		
								AMOUNT	NAME OF ACCOUNT	L. F.
	22 50							18 75	Office Supplies	12
								32 5 -	Factory Rent	40
			13 75					150 -	Office Rent	48
92 80				100 -		298 -				
91 50				100 -		295 -				
621 50	101 40	36 90	71 90	350 -	22 50	952 40	18 75	118 150		
39	11	44	42	45	42	42	30	5		

Illustration 87, Voucher Register (Right Page)

for the amount of each check and the Cash account credited. If discount is allowed by creditors, provision must be made in the check register for recording purchases discount.

The check register in Illustration 88 contains a record of some of the checks issued by the Candy Kitchen during the month of January; the waved line indicates an omission. The checks are entered in the record in the order in which they are issued.

Posting the Check Register. The debits and credits because of each purchase have been recorded in the voucher register, hence there will be no posting from the check register during the month. At the end of the month the total of the first column is posted to the debit of the Vouchers Payable account, the second to the credit of the Purchases Discount account and the third to the credit of the Cash account or if the Cash account is carried in the name of the bank, to the credit of the Bank account. Cash and the equality of the debits and credits recorded in the columns are proved before posting.

Vouchers Payable Account. The purpose of this account is to contain a record of all purchases whether for cash or on credit. It is *credited* at the end of each month for the total of the Vouchers Payable column in the vouchers payable register and *debited* at the end of each month for the total of the Vouchers Payable column in the check register. The *credit* balance is the total unpaid vouchers; it is shown as a current liability on the Balance Sheet.

CHECK REGISTER							
DATE	CHECK NO	VCH NO	IN FAVOR OF	VOUCHERS PAYABLE CR	PURCHASES DISCOUNT CR	NET CASH CR	
19 Jan	2	321	2 Thompson Realty Co	325 -		325 -	
	2	322	3 The Day Machine Co	1375		1375	
	4	323	4 Robt. Hunter	150 -		150 -	
	5	324	5 Fred Smith	81040		81040	
	9	325	7 J. C. East	25		25	
	27	355	110 DeLong & Son	36575	735	36137	
	29	354	51 H. J. Bell	90120		90120	
	30	360	44 Clark Grocery Co	50731	508	50223	
				1650123	12150	1637972	
				30	2	2	

Illustration 88, Check Register

REPORT

Complete Report No. 76 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 77 is required on page 340.

CHAPTER XXVIII

CONSIGNMENT SALES AND INSTALLMENT SALES

The method of recording the transfer of merchandise when it is sold for cash or on credit, and the title passes from the seller to the buyer, has been discussed in preceding chapters. Sometimes possession of merchandise is given without transfer of title. The discussion in this chapter relates to the method of recording such transactions (a) when merchandise is sold on consignment, and (b) when it is sold on the installment plan.

A Consignment is merchandise placed by the owner with another to be sold for the owner. The owner is known as the *consignor* and the one with whom the merchandise is placed as the *consignee*. The title remains vested in the consignor until the merchandise is sold by the consignee. Merchandise received by the consignee from the consignor is referred to by him as a *consignment in*; the consignor refers to this merchandise as a *consignment out*. The merchant who sells merchandise as a consignee is known as a *commission merchant*.

The Relation of the Consignor and Consignee is that of principal and agent. The agent must follow the instructions of the principal in regard to the sale of consigned merchandise which belongs to the principal; in the absence of any specific agreement, the agent is required to follow the usual trade customs applicable to the line of business in which he is engaged. The consignor is responsible to the consignee for all expenses incurred by the consignee in connection with the consignment. The consignee is responsible to the consignor for all merchandise sold by him. The consignee must take the same care of the consigned merchandise as he does of his own merchandise.

Reason for Consignments. The prime purpose of consignments is to sell merchandise. The consignment plan of selling is used whenever the consignor believes it will be to his advantage to retain title until the merchandise is sold or whenever the dealers will not handle his goods on any other terms.

Live stock, cotton, fruit, vegetables, poultry and eggs are examples of the classes of merchandise usually sold through the consignment plan. This plan is also applicable to the marketing of a new product which is unknown to the public. The manufacturer places his product with dealers on consignment. The consignor retains title to the consigned goods until they are sold by the consignee; the consignee does not pay for the goods until they are sold.

Transactions Completed by the Consignor. From the point of view of the consignor, merchandise placed on consignment is only a transfer of his own merchandise from one place to another, hence no transaction is com-

July 6. The Southern Fruit Company received from Thompson and Strong, a check for \$658.95, and an account sales showing the net proceeds resulting from the sale of the berries described as consignment No. 716.

The illustration below shows the account sales; the check is not illustrated because the form is the same as in previous illustrations.

ACCOUNT SALES

Cincinnati, July 5 19__

Southern Fruit Co Address Atlanta

Below please find account sales of 250 crates Berries

Sold by THOMPSON & STRONG, Commission Merchants

Received July 2 19__ and sold for account of yourselves

DATE	CHARGES	QUANTITY	AMOUNT	DATE	SALES	QUANTITY	AMOUNT
<u>July 2</u>	Freight	<u>@ 3</u>	<u>52.80</u>	<u>July 3</u>	<u>100 crates @ 3.25</u>	<u>\$ 1</u>	<u>320 -</u>
<u>2</u>	Drayage	<u>@ 3</u>	<u>2.50</u>	<u>5</u>	<u>100 " @ 3.25</u>	<u>@ 2</u>	<u>325 -</u>
	Returns			<u>5</u>	<u>50 " @ 3.25</u>	<u>@ 2</u>	<u>162.50</u>
	"						
	Advances						
	"						
<u>5</u>	Storage	<u>\$ 1</u>	<u>12.50</u>				
	Insurance						
<u>5</u>	Commission	<u>\$ 1</u>	<u>80.75</u>				
<u>5</u>	Net Proceeds	<u>@ 3</u>	<u>658.95</u>				
			<u>807.50</u>				<u>807.50</u>

Illustration 90, Account Sales

The Southern Fruit Company placed the two hundred crates of berries with Thompson and Strong because it wished to retain title to the berries until sold, hence a check for \$658.95 is, to this firm, the selling price of the berries. For this reason the only entry required is to record the cash and the sale.

The entry in the illustration below shows the method of recording this sale in the cash book.

CASH				Receipts	
Date	L. F.	Account Credited	Explanation	Amount	
19 July	6	Consignment Out No. 716	Net Proceeds	658	95

Consignment Out Account. The purpose of this account is to provide the consignor with a record of the transactions completed with the consignee. The Consignment Out account is debited for the amount of transportation charges when prepaid on consigned goods and credited with the net proceeds when the account sales is received. The credit balance of this account

is the net sales resulting from the consignment and is usually transferred monthly to an account with the title Consignment Sales; if not transferred, the balance of each Consignment Out account will be shown on the Profit and Loss Statement under the title Consignment Sales.

Inventory of Consignment Out. Merchandise in the hands of a consignee is one of the assets of the consignor, the same as merchandise in his store room. The value of the merchandise on consignment is ascertained from the shipping invoice and the cost price. The value of all merchandise on consignment is usually shown on the Balance Sheet separate from the inventory

Merchandise Inventory.....	\$59,321.60
Consigned Merchandise	15,895.51

value of merchandise in stock. Thus, if at the close of a fiscal period, the Southern Fruit Company had merchandise in stock to the value of \$59,321.60 and merchandise on consignment in the hands of consignees, \$15,895.51, this information would be shown on the Balance Sheet as in the illustration above.

Transactions Completed by the Consignee. The merchandise received by the consignee on consignment does not belong to him, hence no transaction is involved when the goods are received. Should the consignor not prepay the transportation charges, the payment by the consignee is a charge against the consignment. As a result of each sale of merchandise belonging to the consignor, the assets cash or accounts receivable increase and the liability Consignment In increases.

When the consigned merchandise has been sold, the consignee will report the sale to the consignor on a printed form known as an *account sales*. At the time this report is made, he will deduct transportation charges which he paid, his commission (profit), and the cost to him for insurance, storage and drayage. In other words, when he makes a report, his liability is reduced the amount of the deductions. When cash accompanies his report, which is usually the case, the liability is canceled and the credit to the Commission Earned account is the consignee's profit on the consignment.

Illustration. The transactions stated below were completed by Thompson & Strong, the consignee, in connection with the consignment referred to in the invoice of shipment and account sales, Illustrations 89 and 90.

- July 2. Paid freight on Consignment No. 716, \$52.80 and drayage, \$2.50.
- July 3. Sold Stein Grocery Company, on credit, one hundred crates of berries from Consignment No. 716 at \$3.20.
- July 5. Sold for cash, one hundred fifty crates of berries from Consignment No. 716 at \$3.25.
- July 5. Rendered an account sales for Consignment No. 716, storage, 5c per crate and commission 10% of sales, net proceeds, \$658.95.

The transactions for Consignment No. 716, stated at the bottom of page 338, are shown in journal form in the illustration at the right. The Consignment account is debited for the freight and drayage in the first transaction, credited for the sales in the third and fourth transactions, and debited for the net proceeds in the fourth transaction. The credits to Storage Income and Commission Income accounts record the income earned because of storage and commission.

July 2, 19			
339	Consignment In No. 716...	55 30	
1	Cash		55 30
	Paid freight, \$52.80; drayage, \$2.50.		
	3		
12	Stein Grocery Company....	320 —	
339	Consignment In No. 716		320 —
	100 crates berries at \$3.20		
	5		
1	Cash	487 50	
339	Consignment In No. 716		487 50
	150 crates berries at \$3.25		
	5		
339	Consignment In No. 716...	752 20	
21	Storage Income		12 50
22	Commission Income		80 75
1	Cash		658 95
	Rendered account sales, storage 5c, com. 10%.		

When the above entries are posted, the Consignment In account will

appear as in the illustration at the left. The account is in balance because the consignor has been paid in full. The credit balance of the Commission Income account shows the profit on the consignment.

CONSIGNMENT IN No. 716

19				19			
July	2	Frt.	J 339	July	3	J 339	320 —
	2	Dray.	J 339		5	J 339	487 50
	5	Stor.	J 339				
	5	Com.	J 339				
	5	N. P.	J 339				
			52 80				
			2 50				
			12 50				
			80 75				
			658 95				
			807 50				

Consignment In Account. The purpose of this account is to provide a record of the transactions completed by the consignee with the consignor. The Consignment In account is *debited* for transportation charges paid and other expenses and deductions in connection with the consignments, and *credited* for the total sales. The *credit* balance is the total amount due the consignor for consigned goods sold and reported to the consignor. Usually the Consignment In account shows a credit balance at the time the Balance Sheet is prepared and is shown as a liability; should the Balance Sheet be prepared before sales are made, it might show a debit balance in which case it would be an asset.

Usually separate accounts are maintained with each consignment and the title of the account includes the terms, Consignment In, the name of the consignor and his address. When a commission merchant carries in stock merchandise for a number of consignors, the separate accounts may be kept in a consignment ledger in which case the Consignment In account in the general ledger is maintained as a control account.

Inventory of Consignment In. Consigned merchandise in the hands of the consignee is not one of the assets of the consignee because the merchandise belongs to the consignor. For this reason, the inventory of consigned merchandise at the close of the fiscal period is not shown on the Balance Sheet of the consignee.

REPORT

Complete Report No. 77 in the work book and present it to the instructor for approval. Continue with the text discussion until Report No. 78 is required on page 344.

Installment Sales. When the buyer is given possession of merchandise under a contract whereby he agrees to pay for it in periodic installments and agrees that the title shall remain with the seller, the transaction is referred to as an *installment sale*. The purpose of the installment sale is to permit the buyer to have the use of the merchandise while he is paying for it and to protect the seller against loss in case the buyer does not pay the agreed installments. When the buyer fails to keep his agreement, the seller can take possession of the goods and thus avoid loss.

Installment sales are applicable to many lines of merchandise such as furniture, radios, electrical equipment for home use, musical instruments and automobiles. Each installment sale may be recorded in the Sales account in the same manner as a sale for cash or on account. The usual plan, however, is to record installment sales so that the income resulting from them during the fiscal period will be only the installments collected during the period. This may be briefly described as follows:

The cost of all merchandise made available for sale is debited to the Purchases account in the same manner as when no installment sales are made. The amount of each cash sale is recorded as a debit to the Cash account and a credit to the Sales account. The amount of each sale on credit is recorded as a debit to the Accounts Receivable account and a credit to the Sales account. The amount of each sale on the installment plan is recorded as a debit to an account with the title Installment Contracts and a credit to an account with the title Installment Sales. An account is maintained with each customer, whether the sale is made on credit or on installment. Accounts with charge customers, that is, those to whom credit is extended, are kept in the accounts receivable ledger and those with installment customers, in the installment ledger. When cash is collected from the installment customer, the Cash account is debited and the Installment Contracts account credited, also the account with the customer in the installment ledger. In other words, the Installment Contracts account controls all the accounts in the installment ledger.

At the close of the fiscal period the balance of the Sales account shows the income from sales either for cash or on credit and the balance of the Installment

Sales account, the income from sales on installment. The balance of the Installment Sales account, however, is not all income because all the installments are not yet collected. The installments yet to be collected represent income to be earned in a subsequent fiscal period, hence it is necessary to ascertain the profit on the installments yet to be collected and record it as a deferred credit to income. The amount of the profit is determined from the balance of the Installment Contracts account. Thus, if the balance of the Installment Contracts account is \$9,000.00 and the merchandise is sold at a profit of 50%, \$3,000.00 is set up as a deferred credit to income because this is the profit applicable to the installments yet to be collected.

Illustrations. The method of recording installment sales in connection with other types of sales and of ascertaining the profit on the installment sales actually collected at the close of each fiscal period is further explained through illustrations. These illustrations are applicable to the transactions completed by the Adams Mercantile Co. during the monthly fiscal period of July. Two columns are provided in the sales journal, one for sales and the other for installment sales. Columns are provided on the receipts side of the cash book for collections from charge customers and collections from installment customers. The illustration at the right contains the entries in journal form to record the purchases and sales during the month. The first entry records the total of the purchases journal, the second the total sales to charge customers, the third

July 31, 19									
342	Purchases.....	40000							
342	Accounts Payable.....		40000						
	To record total purchases for July.								
	31								
342	Accounts Receivable.....	30000							
342	Sales.....		30000						
	To record total sales for July.								
	31								
342	Installment Contracts.....	18000							
342	Installment Sales.....		18000						
	To record total installment sales for July.								
	31								
341	Cash.....	10000							
342	Accounts Receivable.....		10000						
	To record total collections from charge customers.								
	31								
341	Cash.....	6000							
342	Installment Contracts.....		6000						
	To record total collections from installment customers.								

the total sales to installment customers, the fourth the total collections from charge customers and the fifth the total collections from installment customers.

CASH									
19									
July	31	J 341	10000						
	31	J 341	6000						

The accounts at the left and at the top of page 342 show the results of posting the journal entries in the preceding illustration. The balance of the Purchases account

ACCOUNTS RECEIVABLE							
19	July	31	J 341	30000	—	19	July 31 J 341 10000 —
INSTALLMENT CONTRACTS							
19	July	31	J 341	18000	—	19	July 31 J 341 6000 —
ACCOUNTS PAYABLE							
						19	July 31 J 341 40000 —
SALES							
						19	July 31 J 341 30000 —
INSTALLMENT SALES							
						19	July 31 J 341 18000 —
PURCHASES							
19	July	31	J 341	40000	—		

shows the total cost of merchandise made available for sale, the Sales account the sales to charge customers, the Installment Sales account the sales on installment, the Accounts Receivable account the total amount to be collected from charge customers, and the Installment Contracts account, the amount yet to be collected from installment customers. The title of all merchandise sold as shown by the credit of the Sales account has passed to the purchaser, hence the entire amount is regarded as income from sales. The

credit balance of the Installment Sales account, however, is not regarded as income from sales because the title has not yet passed, hence the seller may be required to take possession of merchandise and sell it again.

The illustration at the right is the Trading Statement prepared at the close of the fiscal period. The \$4,000.00 deducted from the Installment Sales account is the income to be earned in the next fiscal period because of installment sales made in this period but not yet collected.

It is assumed that the profit is 50% of the cost of sales. This means that two-thirds of the \$12,000.00 yet to be collected from installment customers is cost of the merchandise sold and one-third, \$4,000.00, is profit to be earned in a subsequent fiscal period when the collections are made. This amount is set up as a deferred credit to income and deducted from the Installment Sales account.

The deferred credit to income here is the same nature as that discussed on page 202.

ADAMS MERCANTILE CO.			
TRADING STATEMENT, July 31, 19			
Income from Sales:			
Sales.....			30000 —
Installment Sales.....	18000	—	
Less Def. Cr. to Income	4000	—	14000 —
Net Sales.....			44000 —
Cost of Sales:			
Purchases.....	40000	—	
Less Inventory, July 31..	8000	—	
Net Cost of Goods Sold..			32000 —
Gross Profit on Sales...			12000 —

The entries in the illustration at the left are made to summarize the trading

accounts into the Trading account and to record the deferred credit to income, as a debit to Installment Sales and as a credit to Deferred Credit to Income. When these entries are posted, the trading accounts will be in balance, the Merchandise Inventory account will show the value of merchandise in stock, and the balance of the Deferred Credits to Income will show the amount of income carried over to the next fiscal period.

July 31, 19

Installment Sales.....	4000	—	
Deferred Credit to Income			4000
To record the profit on installment sales applicable to the next period.			
31			
Trading.....	40000	—	
Purchases.....			40000
To transfer Purchases account to Trading account.			
31			
Merchandise Inventory.....	8000	—	
Sales.....	30000	—	
Installment Sales.....	14000	—	
Trading.....			52000
To transfer accounts with credit balance to Trading account.			

On the first day of the August fiscal period, a reverse entry is made to close the Deferred Credit to Income account to the Installment Sales account because it is income of the next or a subsequent fiscal period.

Repossession of an Installment Sale. The purpose of installment sales is to permit the seller to take possession of the goods if the buyer does not meet his installments. If the seller takes possession of the merchandise, an entry is made to cancel the charge against the customer and to record the merchandise replaced in stock.

Illustration. August 1. The account with A. B. Ames, an installment customer, of the Adams Mercantile Co. shows a debit balance of \$30.00. This is for a purchase of \$48.00 on which a down payment of \$6.00, and four weekly payments of \$3.00 each have been made. August 10, it was necessary to take possession of the merchandise.

The general journal entry in the illustration at the left is to close the account and record the profit applicable to the account which is recorded in the

Installment Sales account because of the reverse entry made August 1. Installment Sales account is debited with \$10.00, profit applicable to this installment yet to be col-

August 10, 19

Installment Sales.....	10	—	
Purchases.....	20	—	
A. B. Ames.....			30
To close the account with A. B. Ames.			

lected. The Purchases account is debited with \$20.00, the cost of the merchandise placed in stock, and A. B. Ames credited with \$30.00 because of the decrease in the value of this asset. If desired, the asset value of the merchan-

disse repossessed may be recorded in an account with the title Repossessed Merchandise and this account also debited with any expense incident to reconditioning the merchandise for sale. When this plan is followed, it will be necessary to record the sale as a credit to the Repossessed Merchandise account and show the balance of this account as a part of the Trading Statement. Unless there are a number of transactions in which merchandise is repossessed and a large expense is involved in making the merchandise available for sale, the better plan is to debit Purchases for all costs of repossessed merchandise and let the profit be shown through the gross trading profit.

Journals. The ruling of the journals required by the Adams Mercantile Co. are shown in the sketches below. The accounts illustrated in the preceding discussion are the results of posting the totals of these journals except the general journal; the general journal illustrated shows special columns for installment sales canceled; this will be necessary only when there are many transactions in which it is necessary to repossess the merchandise sold on the installment plan.

PURCHASES JOURNAL

DATE	L. F.	ACCOUNT CREDITED	ADDRESS	TERMS	INV. DATE	AMOUNT

SALES JOURNAL

DATE	L. F.	ACCOUNT DEBITED	ADDRESS	TERMS	INV. DATE	SALES CR.	INSTALLMENT SALES CR.

CASH RECEIPTS

DATE	L. F.	ACCOUNT DEBITED	EXPLANATION	GENERAL LEDGER CR.	ACCTS. REC. LEDGER CR.	INSTALLMENT LEDGER CR.	NET CASH DR.

CASH PAYMENTS

DATE	L. F.	ACCOUNT DEBITED	EXPLANATION	GENERAL LEDGER DR.	ACCOUNTS PAYABLE DR.	PURCHASES DISCT. CR.	NET CASH CR.

GENERAL JOURNAL

	L. F.	NAME OF ACCOUNT AND EXPLANATION	GENERAL LEDGER	GENERAL LEDGER	INSTALLMENT LEDGER
			DR.	CR.	CR.

REPORT

Complete Report No. 78 in the work book and present it for approval. Continue with the text discussion until Report No. 79 is required on page 350.

CHAPTER XXIX

LAND AND BUILDINGS

The method of recording rent expense when cash is paid for the use of a building is explained in previous chapters. Frequently businesses own the buildings which they occupy and, therefore, do not pay rent, but they do have various expenses in connection with the ownership and maintenance of the property. The method of recording these expenses and of ascertaining the total rent expense is discussed in this chapter.

Real Estate. Land and the permanent improvements located thereon are known as *real property* or *real estate*. The asset real estate is referred to as one unit but for accounting purposes and usually for taxation purposes it consists of two units, (a) the land, and (b) the buildings and other permanent improvements located on the land. This division is necessary because the land will not have to be replaced because of depreciation but the building will eventually deteriorate to a point where it will be necessary to replace it with a new one.

Purchase of Real Estate. The merchant does not usually buy real estate for resale as he does merchandise but rather to provide a home for the business. Real estate purchased as a home for the business is one of the fixed assets of the business. When cash is paid for real estate, the transaction results in an increase in the asset land for the value of the land, an increase in the asset buildings, for the value of the buildings, and a decrease in the asset cash for the amount of cash paid. When a part of the purchase price is to be paid at a subsequent time, the amount of the deferred payment results in an increase in the liability mortgage payable, the indebtedness for real estate usually being secured by a mortgage on the property.

Maintenance of Real Estate. The usual expenses in connection with the ownership of real estate as a home for the business are (a) repairs, (b) real estate taxes, (c) expired insurance on buildings, (d) depreciation on the buildings, and (e) interest on deferred payments. The cost of repairs and interest paid during the fiscal period are recorded at the time the transactions are completed. Taxes, expired insurance, depreciation on buildings and deferred interest payments are recorded at the close of the fiscal period. Interest cost, whether paid during the fiscal period or accrued at the close of the fiscal period, is recorded as a debit to an account with Interest on Mortgage Payable because this interest is a rent expense.

A distinction must be made between capital and revenue expenditures in connection with building repairs and land improvements. The usual dis-

tion is that capital expenditures increase the value of the property and revenue expenditures are those necessary to maintain its usefulness.

Illustration. The following transactions illustrate the purchase of real estate and the expenditures in connection with maintaining its usefulness.

March 1. The Day Laundry, a corporation, purchased for \$25,000.00 (land \$10,000.00, building \$15,000.00) the real estate at 671 Main Street, as a home for the business. Paid \$10,000.00 in cash and executed a mortgage due in three years with interest at 6% for the balance.

March 2. Paid \$102.00 for insurance on the building.

March 5. Gave the Long Construction Company check for \$2,500.00 in payment for constructing a new front and placing the building in condition for occupancy, as per terms of the contract.

May 15. Paid Charles Overman, carpenter, \$25.00 for repairing floors in the building.

The above transactions are shown recorded in journal form in the illustration at the right. The entries are shown in journal form only because the method of recording the cash transactions in the cash book would depend on the columns used.

The first transaction results in an increase in the assets land and building, a decrease in the asset cash, and an increase in the liability Mortgage Payable. The second transaction results in an increase in the asset Prepaid Insurance and a decrease in the asset cash. The third transaction increases the value of the building, hence results in an increase in the asset building and a decrease in the asset cash. The fourth transaction is an expense necessary to maintain the usefulness of the building, hence results in an increase in the Building Expense and a decrease in the asset cash.

March 1, 19			
Land.....	10000	—	
Building.....	15000	—	
Cash.....			10000 —
Mortgage Payable.....			15000 —
Purchased real estate at 671 Main Street.			
2			
Prepaid Insurance.....	102	—	
Cash.....			102 —
Paid insurance on building.			
5			
Building.....	2500	—	
Cash.....			2500 —
Paid for new front in building.			
May 15			
Building Expense.....	25	—	
Cash.....			25 —
Paid for repairs on floors.			

At the close of the quarterly fiscal period May 31, the estimated accrued taxes on real estate were \$131.50; the accrued interest on mortgage payable, \$225.00; the expired insurance on the building, \$25.50; and the estimated depreciation (rate 2% a year), \$75.00.

The entry to record these accruals, the expired insurance and the depreciation is in the illustration at the right. Each of the four expenses is recorded in an account with a title descriptive of the expense. The liabilities because of the accrued taxes and interest are recorded in liability accounts with appropriate titles. The decrease in the asset prepaid insurance is recorded as a credit to the Prepaid Insurance account and the decrease in the value of the building because of depreciation, as a credit to the Depreciation Reserve for Building account.

May 31, 19			
Real Estate Taxes	131 50		
Interest on Mortgage Payable	225 —		
Expired Ins. on Building	25 50		
Depreciation on Building	75 —		
Accrued Taxes			131 50
Accrued Int. on Mort. Pay.			225 —
Prepaid Insurance			25 50
Dep. Reserve for Building			75 —
To record accrued taxes and interest on real estate, expired insurance and depreciation on building.			

The method of showing the details of the rent expense on the Profit and Loss Statement for the Day Laundry Co., May 31, is shown in the illustration at the right. The amounts shown are the results of posting the above journal entries.

General Expense:			
Rent Expense:			
Real Estate Taxes	131 50		
Expired Insurance on Building	25 50		
Interest on Mortgage Payable	225 —		
Depreciation on Building	75 —		
Building Expense	25 —		
Total Rent Expense			482 —

Sale of Real Estate. A sale of real estate is a transaction in which the asset land decreases (cost price), the asset buildings decreases (book value), the asset cash or some other asset increases (sale price), and the proprietorship increases (amount of the profit); if a loss is incurred through the sale, the final effect of the transaction is a decrease in assets and proprietorship. The profit realized from a sale of real estate is credited to an account with Profit on Sale of Real Estate; a loss is debited to an account with Loss on Sale of Real Estate.

January 2. The Davis Co. received \$9,000.00 in cash and a mortgage for \$15,000.00 due in three years for the real property at 512 Vine Street used as a home for the business. The cost price of the land was \$12,000.00, the buildings \$10,000.00 and the recorded depreciation applicable to the buildings \$1,500.00.

This transaction results in an increase in the asset cash \$9,000.00, an increase in the asset mortgage receivable \$15,000.00, a decrease in the asset

land \$12,000.00, a decrease in the asset buildings \$8,500.00 (book value) and an increase in the proprietorship \$3,500.00.

A record of this transaction is shown in journal form in the illustration at the right. The first two debits record the increase in the assets and the third debit, subtraction from the recorded depreciation.

January 2, 19

Cash	9		
Mortgage Receivable.....	15000	-	
Dep. Res. for Buildings.....	1500	-	
Land.....			12000 —
Buildings.....			10000 —
Profit on Sale of R. E.			3500 —
Sold real property at 512 Vine St., cash, \$9,- 000.00 and mortgage re- ceivable, \$15,000.00.			

The first two credits record the subtraction from the asset accounts in which the real estate is recorded and the third credit records the profit.

Lease. The written contract between a business and the owner of real property for possession of the property rented for a specified time is known as a *lease*. A lease may be executed for any desired length of time and should be in writing; when executed for more than a year, a lease must be in writing. The owner of the real estate is known as the *lessor*, and the one to whom the property is leased as the *lessee*.

The amount of rent that the lessee is to pay the lessor as stated in the lease constitutes the rent expense of the lessee. If the terms of the lease require that the lessee pay for any improvements which are necessary in order to adapt the property to his needs or that he pay for repairs to maintain the usefulness, the rent cost of the lessee will be more than that stated in the lease.

Improvements are usually considered capital expenditures and these costs are distributed over the life of the lease. The ordinary current repairs are treated as revenue expenditures and are therefore shown in an expense account which is closed into the current Profit and Loss Summary account.

Illustration. June 1. The Bay Drug Co. leased the building at the corner of 6th and Walnut Streets from A. C. Adams for a period of 10 years beginning July 1 next, at a rental of \$500.00 per month. June 2. Contracted with the King Construction Co. to make the needed changes in the building and have it ready for occupancy July 1, contract price, \$3,000.00.

July 1. Gave A. C. Adams check for \$500.00, July rent.

This transaction results in an increase in the rent expense and a decrease in the asset cash and is recorded as a debit to the Rent Expense account.

July 1. Gave the King Construction Co. check for \$3,000.00 as per contract.

It is quite evident that the full amount of this \$3,000.00 will not be charged as rent expense for the month of July since the expense is necessary in order to occupy the building for ten years. For the reason stated, this transaction results in an increase in the asset building improvements for \$3,000.00 and a decrease

in the asset cash for the same amount. It is recorded as a debit to the Building Improvements account.

July 31. Recorded the building improvements cost applicable to the monthly fiscal period of July as rent expense.

The lease is for 10 years or 120 months, hence the monthly distribution of the \$3,000.00 expenditure is \$25.00. The entry in the illustration at the

July 31, 19			
Rent Expense.....	25	—	
Building Improvements....			25
To record the building improvements expense applicable to July.			

left shows the general journal entry to record the increase in rent cost because 1,120 of the reconditioning cost is now an expense. The debit to the

Rent Expense account records the increase in the rent expense and the credit to the Building Improvements account records the decrease in the asset.

Capital expenditures made at any time during a lease are recorded as assets and distributed as expense over the remaining fiscal periods in the same manner as when made at the time the lease is executed.

Building Revenue. When the business does not need all the space in the building owned or leased and a part of this space is rented to others, the assets received for the use of this space constitute an income known as *building revenue*. This revenue is recorded in an account with *Building Revenue*.

The Land Account is a record of the increases and decreases in the asset land. This account is *debited* with the purchase price and other capital expenditures applicable to the land and *credited* with the cost price of land when sold. The *debit* balance of the Land account is a fixed asset.

The Building Account is a record of the increases and decreases in the asset building. This account is *debited* with the cost price and capital expenditures applicable to the building and *credited* with the cost price when the building is sold. The *debit* balance of the Building account is a fixed asset.

The Depreciation Reserve for Building Account is a record of the estimated decrease in the value of the building because of depreciation. This account is *credited* at the close of each fiscal period for the estimated depreciation applicable to the building; it is *debited* for the recorded depreciation when the building is sold. The *credit* balance of the Depreciation Reserve for Building account shows the amount to be deducted from the debit balance of the Building account to show the book value of the building.

The debit balance of the Land account, the debit balance of the Building account, and the Depreciation Reserve for Building account are shown on the Balance Sheet.

The Building Improvements Account is a record of the capital expenditures to be distributed at the close of each fiscal period during the terms of a lease. This account is *debited* for improvement costs necessary to make

the building more serviceable for the term of the lease; it is *credited* at the close of each fiscal period with that proportion of the capital expenditure which is to be charged as an expense. The *debit* balance of this account is a deferred charge, or fixed asset depending upon the length of time required to write off the total amount.

The Depreciation on Building Account is a record of the expense because of the estimated decrease in the value of the building due to depreciation. This account is *debited* at the close of each fiscal period for the increase in expense because of depreciation. The *debit* balance, which is shown on the Profit and Loss Statement as a part of the rent expense, is closed into the Profit and Loss Summary account.

The Building Expense Account is a record of the cost of repairs of a minor nature which are regarded as expenses at the time the expenditure is made. This account is *debited* for amounts paid for repairs. The *debit* balance, which is shown on the Profit and Loss Statement as a part of the rent expense, is closed into the Profit and Loss Summary account.

The Real Estate Taxes Account is a record of the taxes on real estate paid during the fiscal period or accrued at the close of the period. This account is *debited* for taxes paid or for taxes accrued at the close of the fiscal period. The *debit* balance, which is shown on the Profit and Loss Statement as a part of the rent expense, is closed into the Profit and Loss Summary account.

The Interest on Mortgage Payable Account is a record of the interest paid on deferred payments applicable to the purchase of real estate. This account is *debited* with the increase in interest cost at the time the interest is paid, or at the close of the fiscal period with the accrued interest. The *debit* balance, which is shown on the Profit and Loss Statement as a part of the rent expense, is closed into the Profit and Loss Summary account.

The Mortgage Payable account is of the same nature as Notes Payable in that it is credited with the face of the mortgage when it is issued and debited with the face of the mortgage when it is paid unless the mortgage is paid in installments, in which case the Mortgage Payable account is debited with the amount of each installment.

The Building Revenue Account is a record of the income because of rent received for the use of the building. This account is *credited* for the rent collected. The *credit* balance is an income and is shown on the Profit and Loss Statement either as a deduction from the total expenses incident to the ownership of the building or as "other income." The balance of this account is closed into the Profit and Loss Summary account.

REPORTS

Complete Reports Nos. 79 and 80 in the work book and present to the instructor for approval. Continue with the text discussion until Report No. 81 is required on page 360.

CHAPTER XXX

COMPARATIVE REPORTS

One of the prime purposes of accounting is to provide information regarding the operations of the business which will permit the owner or management to control future operations. Much valuable information for control purposes may be obtained from a comparison of Balance Sheets for consecutive fiscal periods and Profit and Loss Statements for consecutive periods. The discussion in this chapter relates to the information which may be obtained from comparative reports.

Comparative Balance Sheet. When information is desired about the changes in the assets and liabilities and the significance of the changes, Balance Sheets for two or more periods are arranged so that they can be compared readily. Information of the same nature is placed in adjacent columns and the increases and decreases are indicated either in amounts or percentages.

The illustration on page 352 shows two Balance Sheets prepared for The Hall Mercantile Company. The first Balance Sheet was made at the close of the semi-annual fiscal period ending June 30, and the second, at the close of the semi-annual fiscal period ending the following December 31. The changes in assets and liabilities are indicated in the column at the extreme right. The increases are printed in Roman type and the decreases, in italics.

The type of information to be obtained from the comparison of these two Balance Sheets may be briefly described as follows:

(1) The cash balance has decreased \$5,867.10. As the cash balance is large compared to the total assets, this is not, of itself, an unfavorable change, and may indicate that the cash is being used to a better advantage than before.

(2) The Notes Receivable and Accounts Receivable are very small. The sum of these two items is less than the average sales for two weeks as shown in the comparative Profit and Loss Statement on page 354. This indicates that collections are prompt. It is worthy of note, however, that the Notes Receivable increased more than 160%. This may indicate that some customers are having difficulty in making prompt payments and are settling their accounts by notes; this can be determined from an analysis of the Notes Receivable account.

(3) The Merchandise Inventory increased about \$5,000.00 or about 32%. This is not too great an increase since it is in proportion to the increase in sales.

(4) Sufficient depreciation seems to have been recorded on the fixed assets for a period of six months. This indicates that the assets are conservatively valued.

THE HALL MERCANTILE COMPANY

COMPARATIVE BALANCE SHEET FOR TWO SEMI-ANNUAL FISCAL PERIODS ENDING
June 30 and December 31, 19..

<i>Assets</i>	June 30, 19		Dec. 31, 19		Inc. or Dec.
Current Assets:					
Cash	44573	20	38706	10	5867 10
Notes Receivable	1650	—	4300	—	2650 —
Accounts Receivable	4000	—	7000	—	—
Less Reserve for D'btful Accts.	40	3960	110	6890	2930 —
Merchandise Inventory	14079	60	18990	40	4910 80
Accrued Interest Earned	19	40	85	—	65 60
Total Current Assets	64282	20	68971	50	4689 30
Deferred Assets per Schedule	454	30	1314	50	860 20
Fixed Assets:					
Office Equipment	1250	—	1250	—	—
Less Depreciation Reserve	62	50	125	1125	62 50
Store Fixtures	2000	—	2000	—	—
Less Depreciation Reserve	150	1850	300	1700	150 —
Delivery Equipment	4500	—	4500	—	—
Less Depreciation Reserve	450	4050	900	3600	450 —
Building	10000	—	10000	—	—
Less Depreciation Reserve	250	9750	500	9500	250 —
Land	5000	—	15000	—	10000 —
Total Fixed Assets	21837	50	30925	—	9087 50
Goodwill	15000	—	15000	—	—
Total Assets	101574	—	116211	—	14637 —
Liabilities and Proprietorship					
Current Liabilities:					
Notes Payable—Bank	5000	—	—	—	5000 —
Notes Payable—Creditors	2000	—	2500	—	500 —
Accounts Payable	38000	—	47600	—	9600 —
Accrued Wages	495	—	568	—	73 —
Accrued Interest Cost	155	—	54	—	101 —
Total Current Liabilities	45650	—	50722	—	5072 —
Proprietorship:					
Capital Stock	50000	—	50000	—	—
Surplus	5924	—	15489	—	9565 —
Total Proprietorship	55924	—	65489	—	9565 —
Total Liabilities and Proprietorship	101574	—	116211	—	14637 —

Illustration 91, Comparative Balance Sheet

(5) The Land account has increased from \$5,000.00 to \$15,000.00. This may indicate that the business has purchased land for a new home. As the business has a large cash balance, this is satisfactory, providing it has not unfavorably affected the ratio of current assets to current liabilities.

(6) Notes Payable—Creditors and Accounts Payable have increased \$10,100.00, but this is partially offset by the decrease of \$5,000.00 in notes payable to the bank. The net increase of \$5,100.00 is an unfavorable change, particularly when it is considered together with the decrease in the cash balance of \$5,867.10.

(7) The ratio of current assets to current liabilities in the Balance Sheet of June 30 was 2 to 1.42. In the December 31 Balance Sheet, it changed to 2 to 1.47. This is an unfavorable change, when it is taken into consideration that a normal ratio of current assets to current liabilities should be 2 to 1. It is particularly unfavorable since formerly the current assets were mostly cash while now a large per cent consists of notes receivable, accounts receivable, and inventory which may decrease in value before they are turned into cash.

Comparative Profit and Loss Statement. When it is desired to compare income, cost and expenses of a similar nature for two or more consecutive fiscal periods, the Profit and Loss Statements are arranged in comparative form. Information of the same nature is placed in adjacent columns to facilitate making the comparison; the increases and decreases are indicated in amounts or percentages.

The illustration on page 354 shows two Profit and Loss Statements prepared for the Hall Mercantile Company, a corporation. The first statement was prepared for the semi-annual fiscal period ending June 30 and the second for the following semi-annual fiscal period. A comparison of the two statements is shown by the figures in the third column at the right; increases are printed in Roman type and decreases in italics.

The type of information to be obtained from a comparison of these two Profit and Loss Statements may be briefly shown as follows:

(1) Comparison of gross sales. The sales during the second six months increased 31.8%. This indicates a favorable condition.

(2) Ratio of sales returns to sales. The sales returns during the first half of the year were 3.3% of the sales and the latter half of the year, 2.7%. This is a favorable condition because it indicates more satisfied customers.

(3) The gross profit for the first period is 27.3% of sales. In the second, it increased to 29.6%. This indicates that a higher markup is being secured either from the fact that higher prices are being charged or that purchases are being made on a more favorable basis.

(4) Turnover. The turnover for the first six months of the year is 5 and the second six months, 6. This indicates a favorable condition. Turnover is the cost of the merchandise sold divided by the average of the beginning and ending inventory.

(5) Expenses increased from 21.2% of net sales to 23.1%. This indicates a tendency which, if continued, will materially decrease profits in the future.

It is also worthy of note that Administrative Expense has decreased \$2,250.00. This may be due to the fact that certain administrative expenses have been paid during the first half of the year and have been charged as expenses for that period only. If that is the case, the Administrative Expense may again be higher during the next period. If it is accompanied by equally higher expenses in the other divisions, the total expenses may increase until they are out of proportion to sales.

THE HALL MERCANTILE COMPANY

COMPARATIVE PROFIT AND LOSS STATEMENT FOR TWO SEMI-ANNUAL FISCAL PERIODS ENDING June 30 and December 31, 19...

	June 30, 19	Dec. 31, 19	Inc. or Dec.
INCOME FROM SALES:			
Gross Sales.....	110000	145000	35000
Less Sales Returns and Allowances...	3600	4000	400
Net Income from Sales.....	106400	141000	34600
COST OF GOODS SOLD:			
Inventory at beginning of Period.....	16910 80	14079 60	2831 20
Purchases.....	63981 30	89246 40	25265 10
Freight and Drayage In.....	10663 50	14874 40	4210 90
Total Purchases Cost.....	91555 60	118200 40	26644 80
Less Inventory at end of Period.....	14079 60	18990 40	4910 80
Net Cost of Goods Sold.....	77476	99210	21734
Gross Profit on Sales.....	28924	41790	12866
OPERATING EXPENSES:			
Buying Expense.....	3850	6525	2675
Selling Expense.....	7700	13050	5350
Delivery Expense.....	4400	8700	4300
Administrative Expense.....	6600	4350	2250
Total Operating Expenses.....	22550	32625	10075
Net Profit from Operation.....	6374	9165	2791
OTHER INCOME:			
Interest Earned.....	250	650	400
Purchases Discount.....	500	850	350
Total Other Income.....	750	1500	750
Gross Income.....	7124	10665	3541
DEDUCTIONS FROM INCOME:			
Interest Cost.....	500	100	400
Sales Discount.....	700	1000	300
Total Deductions from Income.....	1200	1100	100
Net Income Carried to Surplus.....	5924	9565	3641

Illustration 92, Comparative Profit and Loss Statement

(6) The net profit from operations has increased from 6% to 6.5% of net sales. This is favorable but it must be borne in mind that it is due to a higher markup on the merchandise and not to a decrease in the expense of operation. If the higher markup is due to an increase in prices during the period and is, therefore, unlikely to be repeated in future periods, the increase in net profit may be replaced in future periods by a loss.

(7) Net income. The net income as a result of operating the business during the first six months was \$5,924.00 and during the second six months, \$9,565.00, an increase of \$3,641.00. This indicates a favorable condition.

Method of Showing Comparative Facts. The comparative Balance Sheet and Profit and Loss Statement provide the desired information but not an interpretation of this information. This interpretation may be shown forcefully through graphs.

Graph. A chart presenting comparative facts is referred to as a *graph* or *graphic chart*. There are three forms of graphs in general use, (a) the bar graph, (b) the curved graph, and (c) the circular graph. Each of these forms may be used when presenting facts shown on comparative reports.

A Bar Graph is used to compare totals for two or more periods. Thus, if it is desired to show by a bar graph the net sales for the two fiscal periods as reported on the Profit and Loss Statement, page 354, the bars would be arranged as in Illustration 93.

If the comparison of sales is for six periods, the sales for the first fiscal period being \$50,000.00, the second, \$60,000.00, the third, \$80,000.00, the fourth, \$65,000.00, the fifth, \$75,000.00, and the sixth, \$85,000.00, the facts prepared in bar graph form would be as in Illustration 94.

When desired, the bars in the bar graph may be made to show a comparison of more than one group of figures. Thus, if it is desired to show net sales, cost

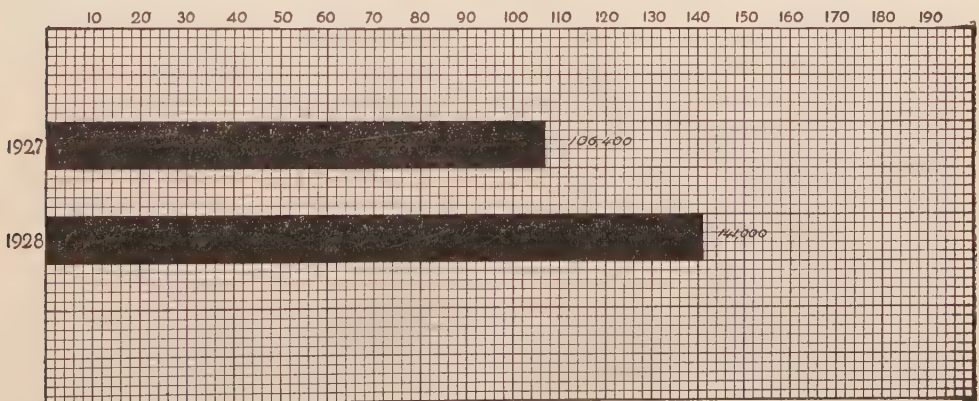


Illustration 93, Horizontal Bar Graph

of sales, selling expense and general expense on the same bar graph for the two periods shown in the Profit and Loss Statement on page 354, the information would be presented as in Illustration 95.



Illustration 94, Vertical Bar Graph

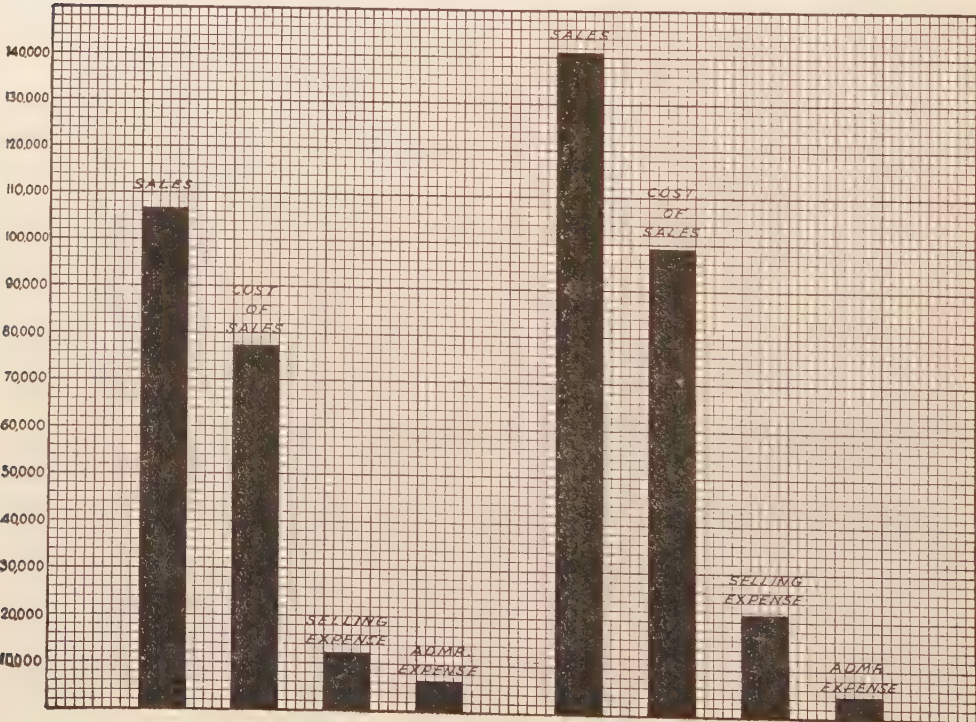


Illustration 95, Vertical Bar Graph

A **Curved Graph** is used to present a comparison of figures over a number of periods. Illustration 96 shows a comparison of net sales and selling expenses monthly for two years.

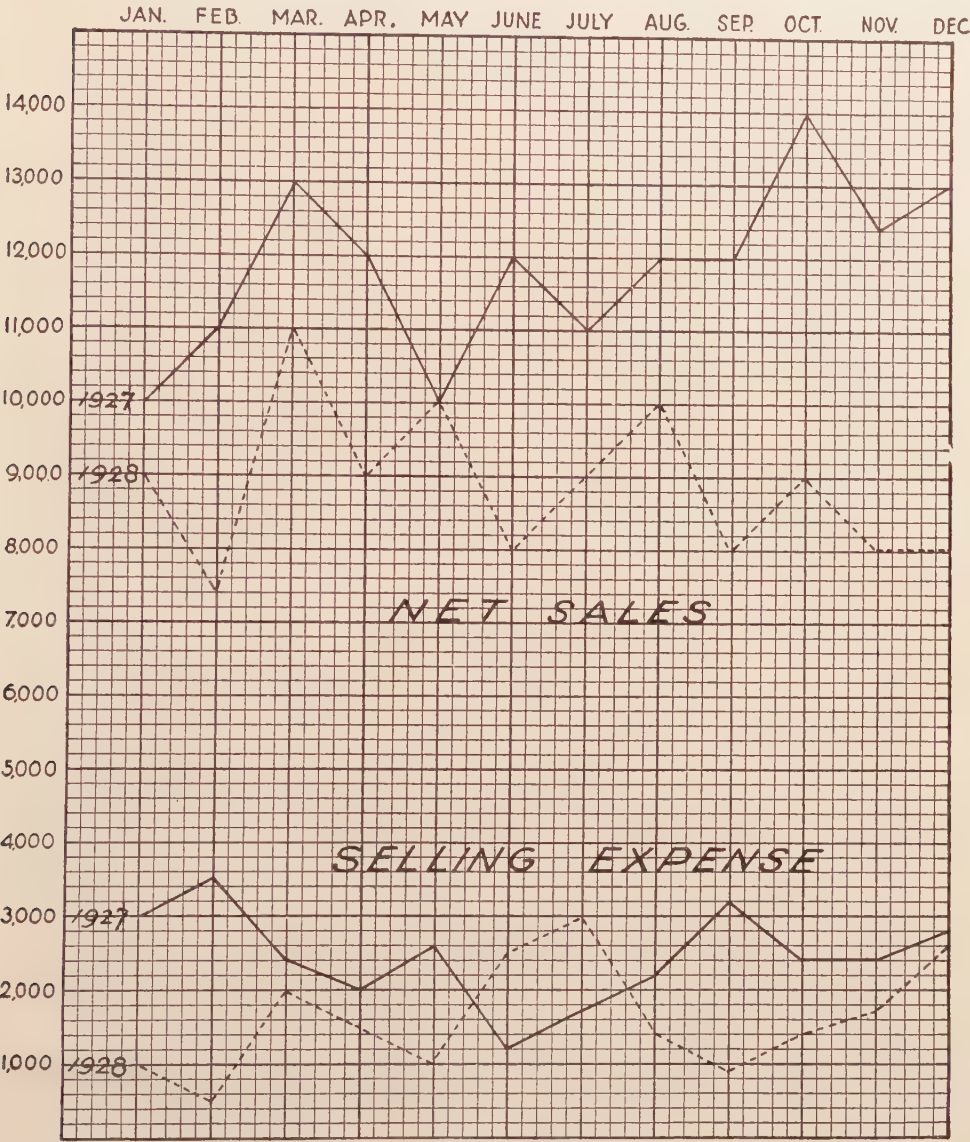
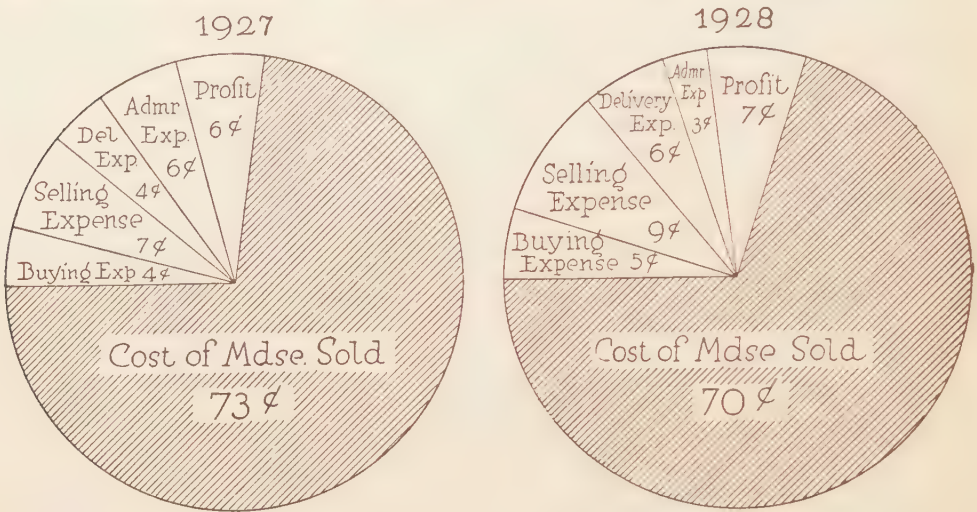


Illustration 96, Curved Graph

A **Circular Graph** is used for presenting figures where a comparison is based on \$1.00 or 100%. Thus, when a merchant receives \$1.00 for a sale, he knows that this dollar must include the cost of the merchandise, the selling

expense, the general expense, and his profit; each cost or expense is regarded as a per cent of the selling cost. This type is less satisfactory than the bar graph.

The two circular graphs in illustration 97 show the method of presenting cost and expenses based on selling price for two consecutive years.



Costs and Profit in Each One Dollar Sale

Illustration 97, Circular Graphs

Percentages are often used to present a comparison of figures and are sometimes even more comprehensive than the graphs or the figures themselves. The base used in figuring percentages must always be stated. If some percentages are based on sales and others on cost of sales, no comparisons can be made. In business, it is customary to use the selling price as the basis in figuring percentages. The base used should always be stated.

When percentages are used to emphasize facts on a Balance Sheet or Profit and Loss Statement they are usually shown in a separate column on each report. Percentages are usually employed to show the relation between different facts on a single report prepared at the close of the fiscal period but they may be used to state the relations between facts for two or more consecutive fiscal periods.

Illustration 98 shows the Profit and Loss Statement for the latter half of the year as illustrated in comparative form on page 354 with the percentages stated in the column at the right; each rate per cent is based on net sales. The circular graph at the right in Illustration 97 shows the costs and profit in each dollar of sales based on the percentages shown in the statement in Illustration 98. From the detailed information in these reports, the management can determine if any of the costs are out of proportion to the sales and the income

therefrom. These percentages are also of value in comparing costs and profits for consecutive periods, since it is much more simple to interpret the information if the figures are expressed in percentage form.

THE HALL HARDWARE COMPANY
PROFIT AND LOSS STATEMENT FOR SEMI-ANNUAL FISCAL PERIOD ENDING
December 31, 19...

			% of Net Sales
INCOME FROM SALES:			
Gross Sales.....	145000	—	103
Less Sales Returns and Allowances.....	4000	—	3
Net Income from Sales.....	141000	—	100
COST OF GOODS SOLD:			
Inventory, June 30, 19.....	14079	60	10
Purchases.....	89246	40	63
Freight and Drayage In.....	14874	40	10
Total Purchases Cost.....	118200	40	83
Less Inventory, December 31, 19.....	18990	40	13
Net Cost of Goods Sold.....	99210	—	70
Gross Profit on Sales.....	41790	—	30
OPERATING EXPENSES:			
Buying Expense.....	6525	—	5
Selling Expense.....	13050	—	9
Delivery Expense.....	8700	—	6
Administrative Expense.....	4350	—	3
Total Operating Expenses.....	32625	—	23
Net Profit from Operations.....	9165	—	7
OTHER INCOME:			
Interest Earned.....	50	—	0.4
Purchases Discount.....	850	—	0.6
Total Other Income.....	1500	—	1
Gross Income.....	10665	—	8
DEDUCTIONS FROM INCOME:			
Interest Cost.....	100	—	0.1
Sales Discount.....	1000	—	0.7
Total Deductions from Income.....	1100	—	0.8
Net Income Carried to Surplus.....	9565	—	7

Illustration 98, Profit and Loss Statement with Percentages

It is necessary to use some one amount on the statement as a basis for the percentages. Net sales are usually used for this because all percentages are

calculated on net sales. Thus, if a salesman is allowed a commission on sales, it is always a certain per cent of the net sales; he does not get credit for sales made to a charge customer and returned. In the same way the charge customer who is allowed discount takes the discount on the net amount of merchandise retained and not on the amount of merchandise purchased. The foregoing explains the reason merchants use the selling price as a basis for ascertaining the percentage of profit on sales. In theory, cost price is the base for percentages but in practice where the cost price is not always known and where all percentage calculations are based on selling price, it is customary to use the selling price as a base for ascertaining profit on sales as well as other percentages.

Referring to the illustration you will note some interesting information all of which has a definite meaning. Thus, gross sales is 103% of net sales. The inventory June 30 is 10% of the net sales. The purchases during the fiscal period is 63% of the net sales, the freight cost 10% and the total purchases cost, 83%. 13% of the merchandise purchased, however, is yet unsold, hence the cost of the goods sold is only 70% of the selling price giving a gross profit of 30%. Out of this profit must come 23% for expenses with some fractions of per cents for non-operating expenses. 7% of the net sales is carried to Surplus.

All of the above information is of value in controlling future operations of the business. The approximate amount of profit may be determined at any time and in connection with any given sale because the percentages of the selling price may be applied to the sales. A percentage statement of this kind prepared at the close of each fiscal period will reflect the changes in the operating cost through the changes in percentages for the various periods. Thus, if the sales decrease and the selling expenses increase, the rate of selling expenses will increase. On the other hand, if the sales increase and the selling expenses stay the same or increase, the increase will be in the same proportion as the sales increase and the percentage will reflect this.

In modern business it is necessary for the management to know at all times the approximate condition of the business. Competition is too keen in modern business to permit carrying on throughout an entire year without having some information in regard to the results of the operations. When possible the accounting department is organized so as to provide monthly statements and these monthly statements are compared with the similar statements for previous years. The ledger is usually not closed at the end of each monthly fiscal period but only at the close of the yearly fiscal period.

REPORTS

Complete Reports Nos. 81 and 82 in the work book and present to the instructor for approval.

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Sept. 13
222.69 562.53 363.32

237.00

	Sept 30	15	30	Sept. 15
C. Paul	23,50	24,50	4,50	11,50
Huber & Winkler	646,50	693,91	1350,74	535,68
Reichle & Brand	89,05-	20,00	199,95	20,00
Lee & Currier	529,98	337,09	221,02	216,43
Dapson & Co	1046,12	562,80	1588,13	122,45-
Staley & Entine	1094,94	675,28	1052,20	325,61

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